INDIAN FEDERAL FINANCE

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To

DR SRIKRISHNA SINHA

Chief Minister, Bihar

FOREWORD

In 1942 Professor B. R. Misra published the first edition of his study of the development and problems of public finance in India—which then, as now, is of great topical as well as of permanent academic interest—under the title *Indian Provincial Finance, 1919-1939*. The book earned well-merited success, and he has now completed an up-to-date revision. Indeed this new edition is in reality far more than a 'revision', as the revolutionary political, economic and financial changes in India arising out of the Second World War, post-war problems, the partition of 1947, the coming of Independence and the new Constitution of 1950, have fundamentally altered both the background and the problems of Public Finance in India. Even the title has become outmoded: there are now no 'Provinces' in India and the former Indian States have become absorbed into the Indian Union, so that Professor Misra has correctly renamed his work *Indian Federal Finance*.

The new Constitution has formally recognized the altered and enlarged scope of federal finance in India by (a) removing the remnants of the constitutional limitations under which the financial system worked under the Act of 1935; (b) extending, mainly through its new planning authorities and policies, the economic functions of the Centre and the States; and (c) fully integrating the former Indian States into the Union.[1] Nevertheless it remains true, as I pointed out in my foreword to the first edition, that public administration, of which public finance is the very core, necessarily takes a pyramidal form. The base consists of local administration—entrusted to local authorities, such as the parish (in England) or the *panchayat* (in India)—upon which rests district administration, which in its turn supports (in India) what was formerly provincial, now state, administration, and finally federal administration. The strength of the whole structure, especially with the extension of governmental economic functions and the increased and increasing reliance upon planning, depends largely upon the

[1] Cf. Professor Misra's *Economic Aspects of the Indian Constitution*, p. 69, Orient Longmans, 1952.

soundness of its foundations. Hence the progressive realization of the ideals of the new Constitution—which may perhaps be summarized as 'political and economic democracy'—depends ultimately upon the development of local self-government, and upon the proper administrative (including financial) co-ordination of the functions and powers of the whole series of authorities. But it is precisely in these spheres that there has, in India, been great weakness in the pact. Local administration and finance are still, despite recent efforts, in an embryonic stage, and until progress is made in this respect it is difficult to see how the state or federal financial systems can be made into effective organs for the implementation of economic planning and the realization of the ideals of economic development and modernization and of a decent standard of life for all, laid down in the Constitution of 1950. The reform and development of the finances and functions of the minor authorities therefore form a necessary preliminary to the creation of a sound and progressive future financial programme for India as a whole.

Professor Misra's study which includes within its purview the history of the development of the present financial structure, local finance, the financial relations between the states and the centre, and the need for greater co-ordination, throws much light upon the weak spots in the existing system and on the principles which should guide financial development. These principles are analysed in relation to welfare in the broadest sense of the term, and not merely in relation to formal financial considerations. Above all it can be said that Professor Misra has depicted the complicated story of the development of the present financial system and has analysed the outstanding relevant problems not in order to promote the programme of a particular party or group of interests, but from a broad and detached—i.e. a truly independent and scientific—point of view.

My pleasure in introducing this new edition, as well as the first edition, to the public is enhanced by the fact that it was my duty to act as Professor Misra's supervisor during his two years' residence in London whilst writing the original volume. I have not been concerned with the preparation of the new

edition, except in so far as the author has kept me informed of his intentions and the progress and form of the new work, but I should like to repeat how much I was impressed, when Professor Misra was working at the London School of Economics, by his untiring pursuit of knowledge, his deep desire to consider all aspects of his chosen theme, and his independence of thought. His conclusions and suggestions will, no doubt, provoke criticism and controversy, but it can at least be said that they represent the honest judgments of a well-informed student of India's economic and financial problems.

VERA ANSTEY

London School of Economics
August 19, 1952

PREFACE TO THE THIRD EDITION

In this edition the text has been thoroughly revised and rewritten. A number of chapters have been introduced for the first time, e.g. Financial Integration (Chapter VIII); Wealth Tax (Chapter XIII); Estate Duty (Chapter XIV); Expenditure and Gift Taxes (Chapter XV); Central Excise Duties (Chapter XVI); Customs Revenue (Chapter XVII) and The Plans (Chapter XVIII). Besides, the matter in the remaining chapters has been revised and brought up to date.

The Indian Financial System is fast changing and an attempt has been made in this edition to bring out the salient features of the tax structure, especially after the publication of the *Kaldor Committee Report on Tax Reform.*

I have retained the Foreword which Dr. Vera Anstey had kindly written for the Second Edition.

I must express my sense of gratitude to my publishers for the unusual care which they have bestowed in bringing my work through the press.

B. R. Misra

Patna University, Patna
December 31, 1959

CONTENTS

I

INTRODUCTORY

§ 1. *POVERTY AMIDST PLENTY*

Causes of 'Arrested' Economic Development

'The most arresting fact about India is that her soil is rich and her people poor.'[1] Here is a country with rich natural resources but the poverty of its people is a byword throughout the world. This paradox of Indian economic life is principally due to overpopulation, lower production, agricultural and industrial, and the absence of a more equitable tax system. A discussion of the first two topics lies outside the scope of this work. Nevertheless, a passing reference to them is essential.

The population of India is rapidly increasing; malaria, hook-worm, smallpox and plague drain the prosperity of the country. The pressure of population on the land has increased considerably with the result that in many tracts of India the majority of the holdings are below the economic size. In the absence of proper manuring facilities and the rotation of crops the practice of a highly intensive cultivation has turned agriculture into robbery of the soil. The general prosperity of India, upon which alone a sound budgetary policy can be framed, can never be substantially increased so long as an increase in income is absorbed by an increase in population.[2] 'The

[1] Darling, M.L., *The Punjab Peasant in Prosperity and Debt,* Oxford University Press, 1932, p. 67.

[2] The growth of population since 1931 is as follows:

Census years	Population (In lakhs)	Increase since the decade
1931	2,755	274
1941	3,128	373
1951	3,569	441

The Census Commissioner, 1951, calculated the following growth of population:

1951	35 millions
1961	42 „
1971	46 „
1981	52 „

population problem lies at the root of the whole question of India's economic future, and it is useless to try to bilk the fact.'[1]

Again, 'the financial problem has undoubtedly been an important factor in the arrested economic development of India.'[2] The reason is not far to seek. On the one hand, the constructive social and economic policy followed by the Government is everywhere creating greater demands upon the public purse; on the other hand the inadequate fiscal machinery meant for raising the revenue from a population consisting mostly of poverty-stricken masses, is getting out of gear. Thus at both ends the pressure is being felt. Hence the discontent with the financial policy of the Government is growing apace. And since the expenditure of the State Governments and local authorities affects the life of the average citizen more intimately than that of the Union Government, the problems of State and local revenues are becoming increasingly difficult and important.

India in 1949

It would be desirable, before entering upon any financial description or discussion, to give a brief account of the main features of the economic life of the States into which India is now divided. The description of the economic conditions, State by State, would involve repetition. Hence a view of India as a whole may be of some advantage.

Before 1947 there were politically two Indias, the British Indian Provinces and the Indian States; British India was governed by the Crown according to the statutes of the British Parliament and the enactments of the Indian Legislature. The Indian States, though under the suzerainty of the British Crown, were for the most part under the personal rule of the Princes. After independence, when the new Constitution came into force, this fortuitous division was done away with and India became one single political entity. Of the 550 odd Princely States:

(i) 216 States, having a total population of about 170

[1] Anstey, V., *The Economic Development of India*, Longmans, 3rd edition, 1936, p. 475. The references throughout this work are to this edition.
[2] Ibid. p. 476.

lakhs, were merged with the neighbouring Provinces which were designated as Part A States;

(ii) 61 States with a total population of about 70 lakhs were constituted into Centrally administered areas known as Part C States;

(iii) 275 States with a total population of about 350 lakhs were integrated to create new administrative units, namely, the Part B States of Rajasthan, Madhya Bharat, Travancore-Cochin, Saurashtra, and PEPSU; and

(iv) 3 States, namely, Hyderabad, Mysore, and Jammu and Kashmir were retained as Part B States but their internal structure, as also their relationship with the Centre, were cast into a new mould so as to fit them into the new constitutional structure.

India before November 1, 1956 was made up of States classified in Four Schedules as follows:[1]

PART A STATES

Names of States	Names of corresponding Provinces under Government of India Act, 1935
1. Assam	Assam
2. Bihar	Bihar
3. Bombay	Bombay
4. Madhya Pradesh	The Central Provinces & Berar
5. Madras	Madras
6. Orissa	Orissa
7. Punjab	Punjab
8. Uttar Pradesh	The United Provinces
9. West Bengal	Bengal

PART B STATES

1. Hyderabad
2. Jammu and Kashmir
3. Madhya Bharat
4. Mysore
5. Patiala and East Punjab States Union
6. Rajasthan
7. Saurashtra
8. Travancore-Cochin

[1] It is impossible to understand the present financial set-up of the country without a reference to the changes brought about in the political map of India in 1949 and 1956.

PART C STATES

1. Ajmer
2. Bhopal
3. Bilaspur
4. Coorg
5. Delhi
6. Himachal Pradesh
7. Kutch
8. Manipur
9. Tripura
10. Vindhya Pradesh

PART D STATES

The Andaman and Nicobar Islands[1]

India in November, 1956

The Constitution had hardly worked for a decade when, mainly for linguistic considerations, it was thought desirable to reorganise the State boundaries. The need for reorganising the States' structure also became necessary in view of national planning. The problem was viewed objectively and dispassionately so that the welfare of the people of each constituent unit as well as of the nation as a whole was promoted. The perspective in which the States Reorganisation Commission formulated its proposals is summed up by them in the following words:

> 'It is the Union of India that is the basis of our nationality. It is on that Union that our hopes for the future are centred. The States are but the limbs of the Union and while we recognise that the limbs must be healthy and strong, and any element of weakness in them should be eradicated, it is the strength and the stability of the Union and its capacity to develop and evolve that should be the governing consideration of all changes in the country.'

As a result of the Report of the Commission, the States Reorganisation Act, 1956, was passed and came into operation with effect from November 1, 1956.

The Indian Union now consists of fourteen States and six Territories. Under the new set-up, more than 98 per cent of the total population of the country is covered by the States and less than 2 per cent by the Territories. No territorial change has been made in the case of Assam, Orissa, Uttar

[1] The above classification is of great significance in understanding the financial system during the period 1949-56. Besides, the Constitution (before its amendment in 1956) had laid down definite financial provisions for the distribution of income-tax and grants-in-aid to Part B and C States. It was one of the special functions of the Finance Commission to keep this classification of the States in view for the distribution of income-tax and *ad hoc* grants.

Pradesh, and Jammu and Kashmir. An entirely new State is Kerala which represents substantially the old State of Travancore-Cochin. The Kannada-speaking areas have been brought together within the State of Mysore. The enlarged Andhra State, a combination of the States of Hyderabad and Andhra, recommended by the Commission, assumed the name of Andhra Pradesh. The two separate States of Bombay and Vidarbha, proposed by the Commission, have been combined to form the new State of Bombay. Himachal Pradesh has been constituted as a Union Territory, as also Tripura and the Laccadive, Minicoy and Amindivi Islands.

The existing States and Union Territories under the Seventh Amendment of the Constitution are as follows:[1]

I. THE STATES

1. Andhra Pradesh
2. Assam
3. Bihar
4. Bombay
5. Kerala
6. Madhya Pradesh
7. Madras
8. Mysore
9. Orissa
10. Punjab
11. Rajasthan
12. Uttar Pradesh
13. West Bengal
14. Jammu and Kashmir

II. UNION TERRITORIES

1. Delhi
2. Himachal Pradesh
3. Manipur
4. Tripura
5. The Andaman and Nicobar Islands
6. The Laccadive, Minicoy and Amindivi Islands

Area and Population

The total area covered by India amounts to 12,66,900 square miles, which is a little more than three-fourths of the total area of undivided India.[2]

India is the world's second most populous country. According to the 1951 census (which covered Sikkim, but did not cover the State of Jammu and Kashmir and the Part B tribal

[1] The new political map of India will undoubtedly facilitate planning in the country and help in the best utilization of the national financial resources. Besides the task of the Finance Commission may perhaps also become easier in the distribution of income-tax and grants-in-aid amongst the States *inter se* as old Provincial/State antagonism may to a large extent be minimized.

[2] The total area of Pakistan is 3,61,000 square miles, which accounts for less than one-fifth of the area of undivided India. The estimated population of Pakistan (1951) is 80,181,000.

areas of Assam) the country's population was 35,68,79,394. The average density of population in India is 312 persons per square mile. It varies considerably from State to State, being as high as 3,017 in Delhi and dropping as low as 10 in the Andaman and Nicobar Islands.

The area and population of India and the component States and Territories are given in the following table:

TABLE 1

AREA, POPULATION AND DENSITY OF INDIA AND THE COMPONENT STATES AND TERRITORIES[1]

	Area in sq. miles	Population	Density of population
INDIA ..	12,66,900	36,11,51,669	312
STATES			
Andhra Pradesh ..	1,05,963	3,12,60,133	295
Assam ..	85,012	90,43,707	176
Bihar ..	67,164	3,87,84,172	572
Bombay ..	1,90,919	4,82,65,221	253
Jammu & Kashmir ..	85,861	44,10,000	51
Kerala ..	15,035	1,35,49,118	901
Madhya Pradesh ..	1,71,201	2,60,71,637	152
Madras ..	50,110	2,99,74,936	598
Mysore ..	74,326	1,94,01,193	261
Orissa ..	60,136	1,46,45,946	244
Punjab ..	47,456	1,61,34,890	340
Rajasthan ..	1,32,077	1,59,70,774	121
Uttar Pradesh ..	1,13,409	6,32,15,742	557
West Bengal ..	33,945	2,63,01,992	775
TERRITORIES			
Andaman & Nicobar Islands	3,215	30,971	10
Delhi ..	578	17,44,072	3,017
Himachal Pradesh ..	10,904	11,09,466	102
Laccadive, Minicoy & Aminidivi Islands ..	10	21,035	2,144
Manipur ..	8,628	5,77,635	67
Tripura ..	4,032	6,39,029	158

From the above table several important conclusions follow, which must profoundly affect the financial system and budgetary policy of the Government. In India, where the average

[1] *India*, 1957, p. 15.

density of population in extensive rural areas exceeds that of almost any other part of the world, extreme poverty must prevail. The assertion that India is not overpopulated, in the face of a smaller produce per head, cannot be supported. Under present conditions 'there is good reason to suppose that in many areas "optimum" population has long since been surpassed'. The excessive pressure of the population must result in a miserably low standard of life for the masses. This must inevitably react on the finances of the Government and make its task more difficult.

Secondly, the unequal distribution of population (combined with physical factors and natural resources) accounts for the conclusion that the standard of service rendered by State Governments—both in quality and in amount—is appreciably lower in the poorer parts of India than in those that are more well-to-do.[1] The above assertion of the Indian Statutory

TABLE II

Per Capita Revenue & Expenditure of Part A & B States (Triennial Average (1952-55)[2]
(In rupees)

	Revenue	Expenditure
Assam	11.57	12.13
Bihar	7.07	7.33
Bombay	17.23	17.43
Madhya Pradesh	9.93	8.77
Madras	10.67	11.03
Orissa	7.70	7.87
Punjab	13.67	13.23
U.P.	8.83	9.03
West Bengal	14.70	15.73
Hyderabad	14.70	14.57
Madhya Bharat	14.03	15.17
Mysore	15.90	15.73
PEPSU	16.00	14.40
Rajasthan	10.13	10.17
Saurashtra	19.53	20.33
Travancore	17.43	15.47

[1] See *Report of the Indian Statutory Commission*, Cmd. 3569, 1930, p. 232.
[2] Calculated from the *Currency and Finance Reports of the Reserve Bank of India.*

Commission (1930) is still supported by the disparities between the total expenditure per head in various States. This is shown in the table on the previous page.

Thirdly, the unequal distribution of population creates difficulties in the allocation of resources. Indeed the vast differences in areas and population make it very difficult to set up any standard for the allocation of resources which may be acceptable to all the States. The authors of the Indian Statutory Commission rightly observed that 'it costs more to run a province with a scattered population than one which is densely populated; the cost of roads and medical and sanitary services must be higher per head.'[1] Hence in any attempt to establish an objective standard of fairness between the States in the distribution of resources the factors of population and areas should be taken into consideration.

Livelihood Pattern

A study of the livelihood pattern of the population is of significance in pointing out the extreme dependence of the masses on agriculture, which in its turn influences the pattern of the tax structure of the country. Seventy per cent of the Indian people depend on agriculture for their livelihood and the remaining 30 per cent live by non-agricultural professions.

Out of every 100 Indians (including their dependants), 47 are mainly peasant-proprietors, 9 mainly tenants, 13 landless labourers, 1 a landlord or rentier (agricultural production), 6 in commerce, 2 in transport and 12 in the services and miscellaneous professions. The table on the next page shows the non-earning dependants and earning dependants among the two major classes and eight sub-classes of the livelihood pattern.

The obvious conclusion which can be drawn from the table on the page opposite is that the pressure of population on the land is very heavy in India. The future budgetary policy of the country is thus most closely linked with the prosperity of agriculture. Unless agriculture is placed on a sounder and

[1] The Finance Commission gives most weight to population in the distribution of income-tax amongst the States *inter se*. *See* Ch. VIII.

TABLE III

DISTRIBUTION OF POPULATION BY LIVELIHOOD PATTERN[1]

(In lakhs)

	Self-supporting persons	Non-earning dependants	Earning dependants	Total
Cultivators of land wholly or mainly owned ..	458	1,001	214	1,673
Cultivators of land wholly or mainly unowned ..	88	189	39	316
Cultivating labourers ..	149	246	53	448
Non-cultivating owners of land and agricultural rent receivers ..	16	33	4	53
Total of agricultural classes	711	1,469	310	2,490
Production other than cultivation ..	122	244	31	377
Commerce ..	59	145	9	213
Transport ..	17	316	3	56
Other services and miscellaneous sources ..	136	268	26	430
Total of non-agricultural classes ..	334	673	69	1,076
GRAND TOTAL ..	1,045	2,142	369	3,566

healthier basis the per capita income of the masses cannot be substantially increased.

For centuries past land revenue was the mainstay of Indian finance. Before the second World War it was by far the largest single source of revenue, forming as much as 45 per cent of the total tax revenue and 33 per cent of the total revenue of the nine Provinces; earlier in 1921-22 it made up as much as 50 per cent of Provincial revenues. Soon after the independence of the country, the Zamindari system was abolished and the State is now the proprietor of the soil. Vast changes have been introduced in the land-revenue system of the country mainly

[1] *Census Report of India*, 1951.

with a view to protecting the interests of the cultivators. The impact of these changes on the financial system has not as yet been felt on the economy of the country. The land tax, however, is yet to be rationalized. We shall deal with this in Chapter XI.

Urban and Rural Population

Of the 35.7 crores who constitute the total population of the country, only 6.19 crores or 17.3 per cent live in the cities and towns, while the remaining 29.50 crores or 82.7 per cent live in villages. There is, however, a slow but steady shift towards urbanisation as shown below:

TABLE IV

Year	Percentage of total population	
	Rural	Urban
1921	88.7	11.4
1931	87.9	12.1
1941	86.1	13.9
1951	82.7	17.3

There has been an increase of 3.4 per cent in the urban population during the last decade, which is more than the combined increase, amounting to 2.7 per cent, during the previous two decades.

There are 3,018 towns and 5,58,089 villages in the country. Seventy-three cities in India have a population of one lakh and over. Twenty-four of the 73 cities crossed the five-figure mark during the last decennium, while only 15 cities did so during the previous decennium.

The Indian village is thus the pivot of administration in the country. Real India lies in the 5,58,089 villages which comprise 82.7 per cent of the population. The above distribution of population raises some fundamental issues in the field of the Indian tax-structure. How far are public revenues raised from rural areas? What percentage of public expenditure is spent on the rural population? How far has planning raised the national income of the countryside? The answers to some

of these and other closely allied questions will be given in some of the chapters of this work.

Agriculture and Budgetary Policy

The predominantly rural character of the population and the dependence of the vast majority of the people upon agriculture has profoundly affected the budgetary calculations and the nature of Indian financial problems. In recent years the food position has continued to cause grave anxiety both to the State Governments and the Central Government. One of the most important reasons for the unfavourable balance of payments is our importing foodgrains. Despite increased production, the overall supply position during 1958 indicated conditions of scarcity and the prices of agricultural commodities, especially foodgrains, continued to show an upward tendency till the middle of 1957. The foodgrain imports in 1956-57 were estimated at 36 lakh tons as compared to 14 lakh tons in 1955-56 and 7 lakh tons in 1954-55. The following table shows the import of cereals into India during the decade ending 1957:

TABLE V

IMPORT OF FOODGRAINS[1]

(In thousand tons)

Year		Rice	Wheat (including flour)	Others	Total
1948	..	867	1,311	663	2,841
1949	..	767	2,200	739	3,706
1950	..	343	1,407	465	2,125
1951	..	749	3,015	961	4,725
1952	..	722	2,511	631	3,864
1953	..	175	1,684	144	2,003
1954	..	603	197	8	808
1955	..	265	435	..	700
1956	..	325	1,095	..	1,420
1957	..	740[2]	2,840[2]	..	3,580[2]

[1] *India*, 1955, p. 261.
[2] Provisional.

The huge import of foodgrains has been one of the most important factors in disturbing the foreign exchange position of the country. Besides it has created enormous difficulties in the field of planning in India. Indeed it is now realized more than ever before that the foremost requisite for the successful implementation of the Plan is to make the country self-sufficient in food. The chronic shortage in food supply also creates enormous difficulties in the budgets of the Central and State Governments.

Land is the most important asset of the country as 70 per cent of the people are dependent upon it for their living. Agriculture accounts for nearly 46 per cent of the total national income. Agriculture supplies raw materials for the major industries, such as sugar, textiles and jute, and provides the bulk of the country's exports. India enjoys a virtual monopoly in jute and lac and is a leading producer of groundnuts and tea. She is the second largest producer of rice, jute, sugar, rape seed, sesamum and castor seed. In a well-operated agricultural policy lies the economic prosperity of the masses upon which alone a sound budgetary policy can be based.

National and Per Capita Income

In order to appreciate the burden of taxation over the community it is desirable to state the growth in the national income of the country. No comprehensive enquiry of the tax incidence in India has yet been made. However, a few outstanding figures relating to the growth in national income are stated here in order to give some idea of the increase in the per capita income during the period 1948-55.

The national income of India for 1954-55 was computed at Rs. 9,620 crores as compared with Rs. 8,650 crores in 1948-49. The per capita income in 1954-55 was reckoned at Rs. 254.4 as compared with Rs. 246.9 for 1948-49.

The national income in 1954-55 was 11.2 per cent higher than in 1948-49 at current prices; while in real terms, that is, assuming a constant price level, the rise in national income during this period was 18.8 per cent. The per capita income

in 1954-55 was 13.8 per cent higher than in 1948-49; while at 1948-49 prices the rise in per capita income amounted to 10 per cent. The table below shows the national and per capita incomes at current and constant prices between 1948-49 and 1955-56. The figures for 1955-56, however, are provisional and subject to revision.

TABLE VI

NATIONAL AND PER CAPITA INCOME (1948-49 to 1955-56)[1]

Year		National income (In crores of rupees)		Per capita income (In rupees)	
		At current prices	At 1948-49 prices	At current prices	At 1948-49 prices
1948-49	..	8,650	8,650	246.9	246.9
1949-50	..	9,010	8,820	253.9	248.6
1950-51	..	9,530	8,850	265.2	246.3
1951-52	..	9,970	9,100	274.0	250.1
1952-53	..	9,820	9,460	266.4	256.6
1953-54	..	10,490	10,040	281.0	269.0
1954-55	..	9,620	10,280	254.4	271.9
1955-56	..	9,650	10,420	252.0	272.1

The index numbers of national and per capita incomes for 1950-51, 1954-55 and 1955-56 (provisional) are given below:

TABLE VII

INDEX NUMBERS OF NATIONAL AND PER CAPITA INCOMES (1948-49=100)

Year		National income		Per capita income	
		At current prices	At 1948-49 prices	At current prices	At 1948-49 prices
1950-51	..	110.2	102.3	107.4	99.8
1954-55	..	111.2	118.8	103.0	110.1
1955-56 (Provisional)	..	111.6	120.5	102.1	110.2

[1] *India*, 1958, p. 188. Figures for 1955-56 are provisional.

The contribution of each of the principal categories of occupations to the national income for 1954-55 was as follows: Rs. 4,350 crores from agriculture, including animal husbandry, forestry and fishery; Rs. 1,810 from commerce, banking and insurance, and transport and communications, including the railways, the post and telegraph and telephone services; and Rs. 1,650 crores from all other services, including the professions and liberal arts, Government services (administration), domestic service and house property. The contributions of these principal categories added up to Rs. 9,620 crores, which also represented the net national income, because the value of the net earned income from abroad was negligible during the year. The percentage distribution of the national income according to its origins is shown below:

TABLE VIII

	1950-51	1954-55	1955-56 (Provisional)
Agriculture	51.3	45.2	43.7
Mining, manufacturing and small enterprises	16.1	18.8	19.4
Commerce, banking and insurance, transport and communications ..	17.7	18.8	19.2
Other services	15.1	17.2	17.7

From the above figures it appears that India is a country with a low per capita income (Rs. 254.4 in 1954-55). The Indian economy is predominantly agricultural, about half of the country's national income is derived from agricultural and other activities which absorb nearly three-fourths of its working force (about 152 million in 1956, inclusive of earning dependants). Any investigation of the manner in which the burden of the tax system is distributed over the different classes must take into consideration the above distribution of the national income according to its origin.

Conclusions

We have now reviewed very briefly the chief characteristics of India, noting in particular the effects of her size, her

population, and the occupations of her people, on her system of public finance. From this brief summary some broad conclusions can be drawn. In the first place, on account of the dominating position occupied by agriculture in the life of the people, the financial problems of the Indian Government are somewhat different from those of western countries. This must change the direction of public expenditure. Secondly, the population problem is undoubtedly one of the most serious obstacles in increasing the quality of the social services supplied by the Government. There are some economists who hold that India can support an even larger population if the best means of production, distribution and consumption are adopted. Be this as it may, the possibilities of future industrialization are of small consolation to the present Government. Thirdly, much of the activity of the Government which helps the cultivator in his difficulties adds enormously to the happiness of the country as a whole. More than thirty years ago the authors of the Montagu-Chelmsford Reforms drew the following picture of the needs of the cultivator:

> 'The ryot and hundreds of thousands of his kind may be lifted from penury to comfort by a canal project costing millions of pounds. One of his constant needs is protection against the exaction of petty official oppressors. Improvements in seed or stock, manures, ploughs, wells; the building of a new road or a new railway; facilities for grazing his cattle or getting wood for his implements; the protection of his crop from wild animals; his cattle from disease and his brass vessels from burglars; co-operative banks to lend him money and co-operative societies to develop his market; the provision of schools and dispensaries within reasonable distance—these are the things that make all the difference to his life.'[1]

The four decades that have passed since the above passage was written have witnessed great growth. Schools have increased, agrarian legislation has been passed, the introduction of agricultural research and experimentation has placed improved methods of cultivation at the disposal of the cultivator, and the number of co-operative societies has

[1] *Report on Indian Constitutional Reforms*, Cmd. 9109, 1918, p. 114.

increased. Still so far only the fringe of the problems has been touched. Hence it is the imperative duty of the Government to assist and protect the interests of the Indian ryot through a judicious system of public finance. 'The rural classes have the greatest stake in the country because they contribute most to its revenues.'[1]

§ 2. *PRINCIPLES OF FEDERAL FINANCE*

Having described some of the features of the Indian economy which affected State finances after the partition of the country, we pass on to discuss some of the fundamental principles of federal finance which should be kept in view in the allocation of resources between the Union and the States.

Allocation of Functions

The problem of the division of taxing powers and functions between a federation and the states or federating authorities, is necessarily one of difficulty. The problem would be simplified if it were possible to allocate separate sources of revenue to the two authorities which would fit in with the economic and financial requirements of each party. But this has not been found possible in actual experience in the financial systems of leading federations. For, as Sir Cecil Kisch has observed, it would be more or less of an accident if the revenue appropriate to federal and state exploitation yielded precisely the sums needed for the discharge of federal and state functions. Nature is not so accommodating. Hence there arises a need for compromises entailing concurrent jurisdiction in the realm of both taxation and administration.

Since the test of the adequacy of the taxing powers of the federation or the states depends upon the functions performed by each, let us start the study by stating the principles upon which the division of functions takes place. Economy, administrative convenience and efficiency have been the leading principles in the distribution of functions. These principles have guided the rival claims of centralization and decentralization. It will appear at once that certain functions can best be performed by the federation, while others are

[1] *See* Cmd. 9109, 1918, pp. 114-15.

more suitable for the federating states or local authorities. Thus functions of an international character, like defence, foreign relations, foreign trade or commerce, or functions which are predominantly national in character, such as railways, currency and coinage, the regulation of inter-state commerce and communication, and so on, are definitely federal and should be administered by the Central Government. Similarly, functions such as education, law and order, police, agriculture, health, medical, are fit for the administration of the federating states or local authorities. It may be mentioned, however, that in some cases it may be desirable to have State administration and Federal legislation to secure uniform progress. We may also have concurrent administration (e.g. conditions of labour).

The actual distribution of functions in a federation depends on a number of considerations. In some federations there may be extreme centralization; in others extreme decentralization. In the main, in most cases, the tendency has been along the lines indicated above. It is not possible to restrict rigidly the scope of Federal and State functions since no China wall exists between them. In practice, there must be some overlapping. But the broad principles of economy, administrative convenience and efficiency should always be a guide whenever any difficulty in the concurrent zone of administration arises.

Distribution of Resources

The rationale of the distribution of resources follows closely the principles adopted in the distribution of functions. Professor Seligman mentions three such principles, viz. the principles of efficiency, suitability, and adequacy. Efficiency and suitability depend upon the nature of the tax and its administration. 'No matter how well intentioned a scheme may be, or how completely it may harmonize with the abstract principles of justice, if the system does not work administratively, it is doomed to failure.'[1] The problems of efficiency and suitability really depend upon the choice between a wide or a narrow tax basis. Where efficiency demands national

[1] Seligman, E.R.A., *Essays in Taxation*, Macmillan, 10th edition, 1951, p. 378.

uniformity combined with effective administration supervision, the tax basis must be wide. Similarly, where the tax varies with localities and its assessment requires the most exact knowledge of local conditions, a locally administered tax will be more efficient. Other taxes less local in character or less well fitted for national assessment, because of administrative difficulties, are obviously suitable for States.

The principles of efficiency and suitability have led to the division of the sources of revenue in a country into three classes: (i) sources of revenue assigned to the Federation; (ii) sources of revenue assigned to the States; and (iii) concurrent sources of revenue in which both the Federation and the States can tax within certain well-defined restrictions. Even this triple division of resources sometimes results in deficits in either the Federation or the States; in such a case the deficit is made up either by federal subsidies or contributions from the States. We shall come to this in the next section. Here we shall briefly state the general scheme of distribution adopted in most federations.

In most federations we find that the exclusive federal taxes consist of indirect taxes, such as customs and excise taxes, receipts from federal property, earnings from commercial monopolies, like those of salt and tobacco, and receipts from commercial undertakings. In the last case the common practice is to have separate budgets for railways and posts and telegraphs. The States generally have powers of direct taxation, such as taxation of incomes, property and inheritances, and state property. The concurrent tax zone is often composed of income-tax, corporation tax, death duties and excises. However, the practice differs from federation to federation.[1]

The Principle of Adequacy

This brings us to the principle of adequacy. The principles of efficiency and suitability are primarily concerned with administrative efficiency. The principle of adequacy has three important aspects: (i) The apportionment of revenues

[1] For an account of the financial practice in some federations, *see* Adarkar, *Principles and Problems of Federal Finance*, P. S. King, 1933.

between the Federation and the States, (ii) the allocation of revenues (in a federation or a state) between different services, and (iii) the question of 'collection', i.e. some taxes may be collected by the federal authority, but shared between the federal authority and the States.

Together with the division of functions between the Federation and the States a simultaneous division of resources becomes essential. The allocation of resources should ultimately rest upon the functions performed by each Government. Here difficulties may arise. First, the division of the sources of revenue, suggested above, though it satisfies the conditions of efficiency and suitability, often fails to fulfil the condition of adequacy, for the functions of the States are usually expanding and require larger resources and the sources of revenue assigned to them are often inadequate for their requirements. Secondly, the yield from the same source of revenue varies greatly in different States. Thirdly, the needs of each State, on account of differences in economic and natural conditions and populations, are different.[1] Hence the allocation of the same heads of revenue to each State breaks down on the principles of adequacy. Therefore, there should be some heads of revenue which should be 'balancing factors' to correct inter-state inequalities.

The Principle of Transferences

The ideal allocation of resources between the Federation and the States should be in accordance with the principle of the 'national minimum' for people living in different states.[2] This can be achieved through transferences from rich areas to poor areas in a federal state. The basic reason for these transferences is to reduce inter-state inequalities of income. It must be remembered that vast inequalities in the distribution of income between people living in various states is not conducive to the prosperity of a nation. The machinery of public finance through a judicious policy of transferences can be employed to correct such inequalities of incomes.

It is unfortunate that whenever an attempt is made to

[1] *See* Chs. III and IV.
[2] *See* Appendix I.

transfer resources from one area to another fierce wrangling takes place between the States. People think in terms of states or artificial provincial boundaries rather than in terms of people. The financial history of the States in India shows that bitter jealousy was caused at the revision of each financial settlement.[1] The ideal of a well-operated system of federal finance should be to provide the national minimum for the people whether they live in one State or another.

The application of transferences cannot be easily achieved. It may be assumed that each State attempts to transfer its resources within its boundaries, from the rich to the poor. The Federal Government should step in to fill up the gaps of unevenness between States caused by differences in natural conditions or population. Thus, poor areas, on account of deficiency of natural resources, heavy population or lack of capital resources, need special treatment. Apart from social considerations, the economic reasons for a federal government to discriminate between the various States are legitimate and clear. The burden of indirect taxes is always heavier on the poorer classes. For example, in India the State of Bihar, on account of the heavy pressure of population, contributes more in customs and excise than the other comparatively richer, but sparsely populated, States. Special subsidies and subventions should be granted in such cases for development expenditure or for other objects to achieve the national minimum. In order that the subsidies or subventions may be properly utilized the Federal Government should exercise some supervision over the financial conditions of the recipient States.[2]

Allocation between Different Services

The other aspect of the principle of adequacy, namely, the allocation between different services, is extremely important. There must be an allocation of resources between the different services, whether they are performed by the Federal or State Governments. The services performed by the State may be

[1] *See* Chs. II III and IV.

[2] The relation of Local Finance to State Finance is discussed in §3 of this chapter and Ch. XX.

divided into two broad classes: (i) general public services and (ii) special public services. The latter may again be divided into three classes: (a) services[1] which can be provided by private enterprise but which the State provides to better advantage on account of administrative convenience and efficiency, e.g. free roads paid for by taxation; (b) services (e.g. poor relief, education, etc.) for which most taxpayers agree to contribute (as suggested elsewhere), on account of what may be called the 'social conscience'; and (c) services in the nature of public utility, e.g. railways, gas, electricity, etc.[2] Here the State restricts the power of monopolies, and often charges discriminating prices.

Let us begin by asking upon what considerations should the State distribute its revenues between these services? How much should it allocate for general public services, social services and public utilities? Clearly, in the first two cases the costs principle cannot operate; in the last, the concept of costs is of fundamental importance. We begin our analysis by saying that all economic activity depends upon the type of state. In dictatorships a disproportionate influence on the policy of the Government by a small minority of persons may lead to a diversion of economic resources into channels different from those in democratic countries. Nevertheless, in most countries the state tries to diminish the inequality of incomes by spending on social services, such as education, public health, medical and poor relief.

In our daily economic life millions of private and business decisions are made by individuals or businessmen between the different courses of action open to them. One individual prefers one decision as compared with another. A man may decide to pass a weekend outside London instead of buying a suit. An enterpreneur controlling the policy of a firm may decide to increase its output and charge discriminating prices from the consumers. Such decisions are mostly determined as a result of a deliberate choice made after carefully considering and rejecting possible alternative courses.[3] They

[1] *See* Appendix I.
[2] *See* Benham, F., *Economics*, Pitman, 1938, pp. 288-99.
[3] Benham, op. cit., p. 7.

ultimately depend upon what economists call the concept of 'opportunity cost'.

In the distribution of public expenditure between various services, with a limited quantity of available resources, the statesman has to eliminate some expenditures and approve others. His choice is affected by two considerations: first, the inherent utility of the expenditure, on the basis of which it is placed on a list of possible expenditures; and second, from the standpoint of the utility of the expenditure under consideration as compared with the utility of other expenditures that are equally possible, on the basis of which it comes to be a preferred expenditure.[1]

The rationale of public expenditure, as stated above, is often difficult to put into practice. The statesman must make a vast multitude of decisions. He must decide how to distribute the available resources among the various services. He must decide how much to spend on the army, the navy, education, public health, and hundreds of other services. A large part of the expenditure is fixed (e.g. the King's Civil List) or is the result of past actions (e.g. interest on war debts). Some expenditure is decided on the spur of the moment (e.g. war emergency expenditure), some is due to vested interests or in order to 'safeguard' the interests of 'minorities'. Nevertheless, most expenditure is the result of deliberate decisions.

The ultimate allocation is an extremely difficult task on which widely different opinions are held by different people. It may be claimed that one scheme is better than another. My own opinion, expressed with all due diffidence, is that a reasoned criticism requires a considerable study of economics and political science. Unfortunately, criticism in India is often based more on sentiment and prejudice than on informed judgement.

Allocation: A Matter of Compromise

To evolve a system of financial allocation in India, in conformity with the principles of efficiency, suitability and adequacy, is an extremely difficult task. Constitutional, natural

[1] Antonio De Viti de Marco, *First Principles of Public Finance*, Introduction by Professor Luidi Einaudi, Cape, 1936, p. 24.

and economic considerations place insurmountable difficulties in its way. A system which would obviously secure efficiency and suitability would break down on the principle of adequacy. Moreover, a system that might suggest itself as the most acceptable would not satisfy the conflicting claims and counter-claims of the various States. Hence financial allocation between the Government of India and the States has always been a matter of compromise. Such 'compromises' are reflected in the system of 'doles' from the Centre to the States or 'contributions' from the States to the Centre or in the system of 'shared revenues'. In Chapters II and III we shall study the history of State finance. Here we shall endeavour to ascertain some underlying principles which must be borne in mind when making a permanent choice in the allocation of revenue resources between the States and the Centre. We shall do this by examining some of the main sources of revenue in India.

Allocation of the Principal Sources of Revenue

Land revenue is one of the most important sources of revenue in India. It must be administered by the State Governments, for the system of land tenure, the basis of assessment, and the types of settlement vary in different States. The State Governments possess the most exact knowledge of local conditions upon which land revenue depends. As agricultural productivity depends upon adequate water supplies the yield from land revenue is closely linked with irrigation. Hence irrigation finance is also a suitable subject for State administration. In fact, irrigation rates are collected along with land revenue. Excise duties on country spirits and intoxicants, on account of administrative convenience, are well fitted for State administration.

The other two heads of revenue where the effectiveness of State administration would increase revenue are forests and stamps. Hence a forest developmental policy needs State interest and supervision. Stamps are divided into two well-marked sub-heads, general and judicial, the former, to preserve a uniformity of rates (in the case of commercial stamps), need Central legislation but State administration:

To increase the effectiveness of administration judicial stamps need State control. Both, however, should be State heads of revenue. This arrangement would secure uniform rates, effective administration and adequate resources for the States which have a free hand in adjusting court fee rates. Central administration of any of these heads of revenue would decrease the efficiency of the administration and the yield.

Just as State administration of revenues in some cases is superior to Central administration, it may also be expected that in some cases Central administration will be superior to State. Customs, salt, railways, posts and telegraphs, opium or excises, by the very character of the tax or service, would undoubtedly be far more efficiently administered by the Central rather than by the State Governments. The extreme difficulty of allocating the yield among the States, the need for uniformity and Central control, and the use of the broadest tax jurisdiction, make them suitable for the Federation.

Some doubts may arise regarding income-tax. Whether the proceeds are apportioned wholly or in part to the States, the collection, assessment and administration, to secure uniformity and efficiency, should be by the Federation. The same reasons apply equally to super-tax, corporation tax and death duties. In modern India, through the working of economic forces, the income of the taxpayers has very little to do with the State in which they happen to live. Thus receipts from the taxation of corporations (whose holdings are spread over the country) cannot be allocated to any State. Hence to avoid the conflicts of tax-jurisdiction, inter-state jealousies and complications (e.g. the movement of labour and capital), these taxes should be collected centrally though the proceeds might be shared. The State Government, however, may be given the right to levy surcharges within a fixed percentage. As the tax revenue would be spent within the State the dangers of excessive taxation should not be exaggerated.

Balancing Factors

On theoretical grounds the above allocation of resources appears to be sound. But on the principle of adequacy it fails.

First, because the yield from land revenue is different in different States. Secondly, the functions of the State Governments are expanding and their sources of revenue are almost inelastic. Thirdly, the needs of each State on account of natural, economic and population considerations are different. Hence, the above allocation is either inadequate for the actual needs or creates inter-state inequalities. Therefore, there must be some heads of revenue which should be 'balancing factors' to correct inter-state inequalities and to introduce an element of greater elasticity in State revenues. In short, certain resources should be transferred from the Federation to the States. The most important heads of revenue which can be admirable balancing factors are income-tax, excises on such commodities as matches, cloth, sugar and tobacco, and the export duties, such as that at present levied on jute.

The allocation of the proceeds of taxation from the balancing factors depends upon various considerations—political, economic, natural and social. The justice (or injustice) of the allocation would depend upon the weight attached to each consideration by the financier. This would vary with his discretion. However, the most important principle which should be the ideal of the financier is to transfer resources from the richer to the poorer States in order to attain the national minimum. In translating this ideal into practice he must be guided, in India, by amongst other factors, (i) the state of its finances; (ii) natural resources; (iii) climate and rainfall; (iv) population; and (v) the state of its economic development. The distribution of the resources by the Federation based upon these factors would fill in the gaps and inequalities resulting from artificial state boundaries or other considerations.

§ 3. *LOCAL FINANCE*

Need for Co-ordination

Finally, there must be co-ordination in financial administration, resources and expenditure between local authorities and State Governments. In a later chapter we shall see that with independent taxes, inadequate resources and growing

local functions, local finance is inefficient and uneconomical. Efficiency and economy in local finance can be introduced by (i) developing the resources of local authorities and (ii) co-ordinating the resources of local authorities and the State Governments through a system of grants-in-aid. The theory of grants-in-aid will be dealt with in Chapter XX. There we shall try to show the main problems of local authorities, and by what methods they are to be solved. For the present, we shall analyse the principles of local finance.

Onerous and Beneficial Services

In a discussion on the principles of local finance it is desirable to distinguish between national or onerous and local or beneficial services—a distinction to which adequate attention has not been paid in the field of local finance in India. This distinction, however, is most important in the theory of grants-in-aid.

The Royal Commission on Local Taxation in England (1901) observed that services which are preponderantly national in character and generally onerous to the rate-payers are 'onerous' and services which are preponderantly local in character and confer upon rate-payers a direct and peculiar benefit more or less commensurate with the burden are 'beneficial'. The Commission further observed that the distinction cannot, it is true, be drawn with absolute logical precision. In many cases it is plain enough, e.g. just as water-rates are held to be payments for services rendered rather than taxes, so also it is clear that drainage works are a local benefit of a similar kind. But in other cases, the two elements are combined in different degrees, since almost all useful local expenditure is indirectly advantageous to the country at large.[1]

Prof. Cannan distinguishes between onerous and beneficial services on the ground of the benefit which local

[1] *Royal Commission on Local Taxation,* Cmd. 638, 1901, p. 12. As a result of the above distinction the Commission came to the conclusion that Poor Relief is a national service; Police and Criminal Prosecution are also predominantly national; and Education is also a national service in a high degree. The maintenance of main roads on the whole is a national service and will become more and more so with the increasing mobility of population and the development of the means of transport and communication.

expenditure confers upon rate-payers. An 'onerous' local service is one which is regarded as a burden because it is not worth to the local taxpayers what it costs them.[1] At another place he further explains the idea: 'Expenditure out of rates receives the name of "beneficial" if its direct effect is sufficient to more than counterbalance the opposite effect of the addition to rates, so that in spite of the addition to rates, it tends to cause an actual rise in the value of immoveable property, while expenditure out of rates which depresses the value of property, is called "onerous".'[2]

Principles of Local Finance

The classification of the local services into onerous and beneficial raises two important problems which have a bearing on the financial relations between the State Governments and local authorities.

These problems are:

(i) The equity of local rates; and

(ii) The financing of local services.

Each of these problems needs close attention.

Local finance differs in one fundamental respect from national finance. Though the object of a government in levying a tax is to render services directly or indirectly to the taxpayer, yet in the case of an individual it is impossible to establish a correlation between the amount of the tax paid and the amount of the benefit received. The essence of a tax, says Prof. Taussig, 'as distinguished from other charges, is the absence of a direct quid pro quo between the taxpayer and the public authority'. In local taxation, however, in some cases, it is possible to measure the benefit received and to correlate this with the amount of the tax paid. Some local taxes are specially levied to benefit the inhabitants of particular localities.

While discussing the benefit and ability theories of taxation we observed that while the ability theory has a greater application in national finance, the benefit principle comes into play

[1] Cannan, E., *History of Local Rates in England,* P. S. King, 2nd Edition, 1912, p. 168.

[2] Cannan, op. cit., p. 168.

in local taxation. It should not, however, be inferred from the above statement that the principle of ability has no place in local finance. The principles of local finance correctly enunciated must contain both elements. The difference between the principles of national finance and local finance comes to this: whereas in national finance great weight should be given to the ability principle, in local finance greater weight should be given to the benefit principle. Both the principles in a judicious system of taxation must supplement each other.[1]

The principles of local finance have been put by Prof. Cannan thus:

(i) That every inhabitant of a district should be made to contribute according to his ability; and

(ii) That everyone who receives benefits from local expenditure should be made to contribute in proportion to the benefits he receives.[2]

These two principles, applied to the same rate, are obviously incompatible; ordinarily the benefits conferred by any kind of Government expenditure are hardly in proportion to the ability of the taxpayer. But in local taxation it happens in practice that taxes on property benefit the persons in proportion to their ability to contribute. Everyone agrees that the supply of important beneficial services, e.g. water supply, drainage, town improvement, lighting, the regulation of traffic, the construction and maintenance of local highways, paths and bridges, should be paid for by each individual in proportion to the benefit secured by him. In practice, however, an actual measurement of the quantity of the commodity or service taken is either impossible or difficult and expensive. To measure the quantity of roads consumed by a particular person or the street lighting required by a person is impossible. Hence a tax on annual value is often levied by municipalities for financing some of the beneficial services. This assumes that the benefit received by a taxpayer is proportional to the value of property owned by him. Similarly it is thought that the value of property owned reflects his ability to pay the tax.

In some cases, for separate services where accurate

[1] *See* Appendix I.
[2] Cannan, op. cit., p. 159.

measurement is possible separate charges are made. The proportional cost of service principle is illustrated where municipalities charge for water on the quantity of water consumed, viz. by fixing meters. But where the water-rate is fixed in proportion to the rental value of property, the charge is progressive, as houses of small rental value evidently use proportionately more water than those of high.

It may be asked on what principle should a local authority fix its charges for beneficial services which are in the nature of public utilities? The costs of such services may be divided into two parts: (i) marginal costs and (ii) fixed costs. Theoretical considerations enable us to say that each consumer should pay the marginal cost of the service incurred by the local authority. In allocating fixed costs some difficulty arises. It is sometimes held that fixed costs should be met out of general revenue. This method is, I think, unsound; for there is no reason why those who do not consume the service should pay a subsidy for the supply of the service. It is fair, I think, that the users of services should pay the fixed costs in proportion to their use. The adoption of this principle would mean that every consumer should pay the marginal costs while those who consume a larger quantity of the service should pay more towards fixed costs than those who consume less. No doubt, in some circumstances (for example, the supply of water in a tropical country) social considerations may demand that relatively rich people should pay for relatively poor people; but theoretically in the case of public utility services the best course is not to raise funds for the subsidy to be distributed among the poor in proportion to their consumption of a particular commodity.

The adoption of the above principle would not cause administrative inconvenience; for example, in the case of electricity the fixed costs may be allocated on the number of points a person may have in his house.[1]

Onerous services benefit not only the locality but the nation as a whole, for instance, education. Local children

[1] Incidentally, it may be mentioned here that the State should help the poor in other ways, e.g. by providing free elementary education, rather than by distributing the fixed costs on the general body of taxpayers.

receive the education but the nation is benefited. Under the present conditions of local finance in India either the residents of poor areas are not provided with the necessary minimum of onerous services or they are required to pay disproportionately higher taxes than they should be required to pay. The system creates inequalities of local taxation between individuals and between districts.

To make local taxation more equitable as between individuals and districts, expenditure on onerous services should be borne jointly by State Governments and local authorities. The result of this change would be that when applying the principle of ability in local finance, we should take into consideration the actual circumstances of each locality and transfer any part of the local burden to State funds which the locality is unable to bear. The transfer of local burdens to State funds would bring about a fairer distribution of tax burdens between both individuals and districts.[1]

[1] For further discussion *see* Ch. XX.

II

HISTORY OF PROVINCIAL FINANCE
(1833-1919)

A knowledge of the history of the financial settlements between the Central and the Provincial Governments is necessary in order to appreciate the nature and extent of the changes brought about by the reforms of 1919. The historical background has an important bearing on present and future financial arrangements and cannot be altogether ignored. Doubtless it is impossible to correct past mistakes and it is useless to revive old controversies, yet a knowledge of the past ensures foresight and care in shaping the future policy of the country. I shall, therefore, trace briefly the history of the financial settlements prior to 1919 in order to understand the changes brought about by the Reforms.

§ 1. *CENTRALIZED SYSTEM OF FINANCE* (*1833-71*)

The Charter Act of 1833

In the field of provincial finance prior to 1871 both revenue and expenditure were rigorously centralized in the Central Government. The centralized system of finance was the necessary result of the centralized system of administration. During this period (1833-71) no Provincial Government could keep any part of its collections or undertake any expenditure without the previous sanction of the Government of India.

The Charter Act of 1833 is a landmark in the history of Indian administration and finance. It introduced a system of centralized administration and vested the superintendence, direction and control of the whole civil and military government and revenues in the Governor-General of India in Council. In regard to finance, it was laid down that, without the previous sanction of the Governor-General in Council, the Provinces were not to spend the revenues allowed to them

in creating any new office, or granting any salary, gratuity or allowance.[1] This rigorous control of the Central Government in provincial financial matters is described by the Strachey brothers in the following words:

> 'The Local Governments (*i.e. Provincial*), which practically carried on the whole administration of the country, were left with almost no powers of financial control over the affairs of their respective provinces, and no financial responsibility. Everything was rigorously centralized in the entire distribution of the funds needed for the public service throughout India. It controlled the smallest details of every branch of the expenditure; its authority was required for the employment of every person paid with public money, however small his salary; and its sanction was necessary for the grant of funds even for purely local works of improvement, for every local road, and every building, however insignificant.'[2]

Political and military exigencies made it difficult to draw exact lines of demarcation between the functions of the Imperial and Provincial Governments. In fact the whole tendency was towards the centralization of administration. The increasing ease and rapidity of the means of communication, the spread of the use of the English language, the material development of the country and the increasing interest taken by Parliament in the details of Indian administration were some of the circumstances which favoured centralization.[3]

[1] So rigorous was the control that the court of directors strongly condemned the action of Mr. A. Ross, the acting Governor of the North-Western Provinces, who, anticipating the sanction of the higher authorities, had abolished three customs houses in the interior of the Province. The dispatch concluded with these strong words: 'Such is the sense of the extreme want of judgment manifested by Mr. Ross on this occasion that, supposing he still continued to exercise the functions of government in the Presidency of Agra, we should have come to the conclusion of cancelling his appointment. In exercise of those powers we deem it necessary to direct that the administration of the Government of Agra be never again, under any circumstance, delegated to Mr. Ross.' *See* Dispatch of the Court of Directors to the Government of India, February 1, 1837, quoted in Banerjee, *Provincial Finance in India*, p. 16.

[2] Strachey, Sir John and Lt. Gen. Richard, *Finances and Public Works of India* (from 1869 to 1881), Kegan Paul, Trench, 1882, p. 134.

[3] See *Report of the Royal Commission upon Decentralization in India*, Cmd. 4360, 1908, par. 47.

Defects of the System

This highly centralized system of finance was open to a number of gross abuses. The Provincial Governments administered the country but had no financial responsibility. This divorce of financial responsibility from administration resulted in extravagance. Economy comes with responsibility. When the responsibility for finding revenues rested with the Government of India, the Provinces, as was natural, asked for as much as they could. They thought that 'they had a purse to draw upon of unlimited, because unknown, depth; they saw, on every side, the necessity for improvements; their constant and justifiable desire was to obtain for their own provinces and people as large a share as they could persuade the Government of India to give them out of the general revenues of the empire; they found by experience that the less economy they practised, and the more importunate their demands, the more likely they were to persuade the Government of India of the urgency of their requirements. In representing and pressing those requirements, they felt that they did what was right, and they left to the Government of India, which had taken the task upon itself, the responsibility of refusing to provide the necessary means.'[1]

Thus the distribution of the funds was based not upon any fixed principle, or on the resources, needs or expenditure of the provinces, but according to the relative claims and demands of each Provincial Government on the purse of the Government of India. The result, in the words of General Richard Strachey, was that 'the distribution of the public income degenerates into something like a scramble, in which the most violent has the advantage, with very little attention to reason.'[2]

Moreover, the Government of India because of the absence of an efficient machinery of audit and the vast area of the country could not exercise an effective control over provincial expenditure. A careful system of audit and accounts had hardly developed. The budget grants were never carefully prepared or checked. In brief, as Dr. Ambedkar put it, so long as the

[1] Strachey, op. cit., pp. 136-7.
[2] Ibid., p. 137

Government of India remained without an appropriation budget and a centralized system of audit and account, it continued to be only a titular authority in the matter of financial control, and the Provinces, though by law the weakest of authorities in financial matters, were really the masters of the situation.[1] Thus the centralized system of finance gave rise to financial irresponsibility and put a premium on inefficiency and extravagance.

Indian Council Act (1861)

In 1858, as a result of the nationalistic revolt of 1857 the administration of India passed from the East India Com, pany to the Crown. The final control of the finances wa- then vested in the Secretary of State for India. So far as the internal control was concerned, the India Councils Act (1861) did not modify the control of the Central Government over provincial financial matters. Centralization was still the most conspicuous feature of Indian administration.

A Period of Deficits

The financial needs of the country, however, on account of the huge deficits and debts left by the Company and the fast-growing public needs, required large sums of money to maintain a financial equilibrium. The situation became extremely acute. In spite of the drastic economy in expenditure and improvements in the machinery of financial administration, Mr. James Wilson, the Finance Member, could not restore financial equilibrium. Mr. Wilson in summing up the financial position in his financial statement for 1860-1 said: 'We have a deficit in the last three years of £30,547,488: we have a prospective deficit in the next year of £6,500,000; we have already to our debt £38,410,755.'[2] It was these Imperial deficits which suggested a policy of financial decentralization.[3]

[1] Ambedkar, B. R., *The Evolution of Provincial Finance in British India*, P. S. King, 1925, p. 27.

[2] See Financial Statement, 1860-1. Speech of Mr. James Wilson, February 18, 1860, India Office Library, p. 6.

[3] During the period 1834-35 to 1857-58, there were seventeen years of deficit budgets and only seven years of surplus. The public debt of India between 1834 and 1857 increased from £41,350,952 to £59,441,052.

§2. *FINANCIAL LANDMARKS IN THE LATER NINETEENTH AND EARLY TWENTIETH CENTURIES*

Lord Mayo's Reforms (1890)

From 1661 to 1870 eminent public administrators had held divergent views regarding the transfer of the control of financial responsibilities from the Imperial to the Provincial Governments.[1] On December 14, 1870, Lord Mayo issued the famous Financial Resolution in which he proposed to enlarge the responsibility and control of the Provincial Governments in respect of the details of their own expenditure. Lord Mayo said: 'I believe, as I have repeatedly said, that if we place administration of portions, both of our revenue and expenditure, in the hands of the local Governments, it will lead to economy, to increased responsibility, to the avoidance of much administrative difficulty, and above all, it will enable the rulers of the country gradually to institute, in various parts of the Empire, something in the shape of local self-government, and will eventually tend to associate more and more the natives of this country in the conduct of public affairs.' Services, like jails, police, education, roads and civil buildings, were transferred to the charge of the Provincial Governments. To meet the cost of these services (£4,514,332) on the basis of the figures of 1869-70, Lord Mayo transferred the excise receipts of £2,000,000 and a lump-sum assignment of £1,500,000; the remaining million pounds was to be raised by the Provincial Governments by extra local taxation.[2]

Advantages of the Scheme

Lord Mayo's scheme was the first step in the financial decentralization of the country. The scheme, it was expected,

[1] As early as 1861, Mr. Laing, the successor of Mr. James Wilson, advocated financial decentralization. Mr. Laing observed:

'It is most desirable to break through the system of barren uniformity and pedantic centralization which have tended in times past to reduce all India to dependence on the bureaux of Calcutta, and to give to local Governments the power and the responsibility of managing their own local affairs.' See *Financial Statement, 1861-2*, Speech of Mr. Samuel Laing, Finance Member, April 16, 1862, p. 89 (Financial Statements, 1860-6 to 1873, India Office Library).

[2] *See* Banerjee, P., *Provincial Finance in India*, Macmillan 1929, p. 62.

would produce greater care and economy in public expenditure, import an element of certainty into the financial system and ultimately result in creating harmonious feelings between the Central and Provincial Governments. 'Above all,' wrote Lord Mayo, 'local interest, supervision and care, are necessary to success in the management of funds devoted to education, sanitation, medical, charity and local public works. The operation of this resolution in its full meaning and integrity will afford opportunities for the development of self-government, for strengthening municipal institutions and for the association of natives and Europeans, to a greater extent than heretofore, in the administration of affairs.'

Lord Mayo's scheme of decentralization was prompted by two objects, namely relieving the Imperial Government from the financial chaos caused by constant deficits by developing local sources of revenue, and secondly developing a sense of responsibility in Provincial Governments by the economical management of their finances.[1] The second object was based on the elementary principle of public finance that tax administrations and appropriation must, as far as possible, go together. That both these results were happily realized can hardly be challenged by any critic of the scheme. A study of the provincial budgets between 1871-72 and 1876-77 shows that surpluses outnumbered the deficits both in frequency and magnitude and even the deficits could easily have been met from the accumulated balances of the past. The Imperial Government directly gained an annual relief of £330,801; besides there was an improvement in the efficiency of the services transferred to the charge of the Provincial Governments.

Defects of the Scheme

Perhaps the greatest defect of Lord Mayo's scheme was that the settlement of 1871 was based on the actual expenditure of the Provinces for 1870-71. The expenditure of that year, on account of past inequalities, was very unequally distributed. The expenditure of Bombay, for example, on the services

[1] Between 1860 and 1870 the three Indian Finance Members could only show three surplus years, in spite of the constant enhancement of taxation, rigid economy and retrenchment.

transferred was more than double that of Madras and the United Provinces, and nearly treble that of Bengal.[1] The Central Provinces and the Punjab were also far behind Bombay in the scale of expenditure. Mr. Gokhale in his evidence before the Welby Commission, 1896, said: 'The fact is that these inequalities are a legacy from the pre-decentralization period, when the expenditure of different Provinces was determined . . . not by the resources or requirements of those Provinces, but by the attention that their Governments succeeded in securing from the Central Government, i.e. by the clamour that they made. And when the first step was taken in 1870 in the matter of decentralization, the level of expenditure that had been reached in the different Provinces was taken as the basis on which the contracts were made, and the inequalities that then existed were, so to say, stereotyped. I think it is high time that an effort should be made gradually to rectify these inequalities.'[2]

Thus were laid the foundations of the inequalities in provincial finance—inequalities which became stereotyped with each step taken towards the financial decentralization of the country. The successive financial settlements not only did not remove the inequalities of the past but accentuated these disparities, with the result that the task of future financiers has become extremely difficult. The policy of doles and contributions to meet the exigencies of the times (besides some other reasons) has made it impossible to do justice in the inter-provincial assignment of funds. Thus some of the most difficult present-day problems of financial adjustment of burdens and resources among the provinces owe their origin to the days of extreme centralization. The authors of the Reforms and the Federal Constitution had to face extreme difficulties in solving the financial problems relating to interprovincial claims and counter-claims. This, however, is to anticipate the discussion.

Lord Lytton's Reforms (1877)

The next step in financial decentralization was taken by

[1] *See* Gyan Chand, *The Essentials of Federal Finance*, Oxford University Press, 1930, pp. 36-7.

[2] Evidence of Mr. G. K. Gokhale, *The Welby Commission Report*, Vol. III, p. 217, Q. 18094, Cmd. 130, 1900.

Lord Lytton in 1877. Undoubtedly Lord Mayo's Government had effected a large reform, yet it suffered from the effect that the services which it left to the management of the Provinces were few. It also did not give the Provinces an effective inducement to develop the revenues collected within their territories. Moreover, the rigidity of the system of assignments was not favoured by the Provinces, because while the revenues collected within their territories were increasing, the assignments allotted to them did not increase. It was also recognized that in order to encourage economy the interference of the Government of India in the details of provincial administration should decrease. That economy and good management go together was clearly realized by Sir John Strachey, who in his financial statement of 1877-78 stated that good management of finance was to be had 'not by any action which gentlemen of the financial department, or any other department of the Supreme Government, can take whilst sitting hundreds or thousands of miles away in their offices in Calcutta or Simla; not by examining figures and writing circulars; but by giving to the Local Governments a direct and, so to speak, a personal interest in efficient management.'[1]

Under the settlements the financial control of services like land revenue, excise, stamps, law and justice, and general administration was transferred to the Provincial Governments, and at the same time the revenues raised from law and justice, excise, and the license (now income) tax was handed over to the Provinces. But as the departmental receipts from the services committed to the Provinces fell short of their requirements, the margin of deficit had to be met by an assignment. This was determined after taking into account the normal yield of the assigned revenues and their normal rate of growth. Further, any increase over the revenue, as it stood at the time of assignment, was shared between the Government of India and the Provinces—the former had also to bear a share in any decrease.[2] However, an important departure was made with Burma and Assam (1879) which were given a share of the land revenue instead of fixed assignments.

[1] Strachey, op. cit., p. 143.
[2] *See* Cmd. 4360, 1908, p. 27.

Madras refused to accept the new system and continued to receive its revenue under the settlement of 1871.

Settlements of 1882

These settlements remained in force from 1877-78 to 1881-82. In 1882 fresh settlements were made with all the Provinces. The most important principle introduced by the settlement of 1882 was that instead of giving the Provincial Governments fixed grants of revenue they were granted the entire yield of some of the sources of revenue and a share in certain Imperial sources of revenue. Here we meet for the first time the classifications of revenue into 'Imperial', 'Provincial' and 'Divided'. The receipts from customs, salt, opium, post office and telegraphs, remained wholly Imperial. The income from forests, excise, license (income) tax, stamps and registration were divided equally between the Government of India and the Provinces; while the income classified under the head 'Provincial Rates' was made entirely provincial and 'local'. Besides the departmental receipts from law and justice, public works and education were also provincialized. The bulk of the income from railways and irrigation remained Imperial.[1] Along with this division of incomes there was also a division of expenditure, which, generally speaking, followed the incidence of the corresponding heads of receipts. But as the expenditure devolving on the Provincial Governments was larger than the revenues assigned to them, the difficulty in adjusting means to needs remained. Hence the excess of provincial expenditure was made up by assigning to each Province a percentage of the land revenue, which otherwise was an Imperial source of revenue.

By these settlements the Provincial Governments were given a direct interest not only in the provincial sources of revenue but also in the divided heads raised within their jurisdiction. The settlement also harmoniously united, to a considerable extent, the financial interests of the Central and Provincial Governments, which now not only shared the receipts but also the expenditure on certain heads. The system of divided heads remained the most important feature of

[1] *See* Cmd. 4360, 1905, p. 28.

provincial finance till it was abolished by the Reforms of 1919.

Defects of Quinquennial Settlements

The settlements of 1882 were quinquennial, and accordingly the provincial settlements were revised in 1887, 1892 and 1897. No change in principle was introduced at these revisions except that as the shares of divided heads were insufficient for the growing needs of the Provinces, they received, in addition, a special fixed assignment adjusted under the land-revenue head.[1]

The main object of the quinquennial settlements (as compared with the annual) was to introduce an element of greater financial stability for the Provinces; but in actual practice the provincial settlements caused much irritation and friction between the Central and Provincial Governments. The most important cause of ill-feeling between the two authorities was the resumption of the provincial surpluses by the Government of India at the close of each quinquennial settlement. The periodical revisions encouraged extravagance rather than economy, and introduced an element of uncertainty in place of stability. A trenchant criticism of the settlements was given by Sir A. Mackenzie, the Lieutenant-Governor of Bengal, in his speech in the Imperial Legislative Council in 1896. He said: 'I deprecate the way in which these quinquennial revisions have too frequently been carried out. The provincial sheep is summarily thrown on its back, close clipped and shorn of its wool and turned out to shiver till the fleece grows again. . . . The normal history is this: two years of screwing and saving and postponement of work, two years of resumed energy on a normal scale, and one year of dissipation of balances in the fear that, if not spent, they will be annexed by the Supreme Government at the time of revision.'[2] Finally, the quinquennial settlements crystallized the financial inequalities started in 1871, as no attempt was made in them to bring the provincial expenditure on to a common footing of equality.

[1] *See* Cmd. 4300, 1908, par. 58.
[2] Quoted in Gyan Chand, op. cit., p. 56.

Quasi-Permanent Settlement (1904)

The year 1904 witnessed an important departure in the history of provincial finance—the introduction of quasi-permanent settlements. Under this system the revenues assigned to a provincial government were definitely fixed and were not subject to alteration by the Central Government save in the case of extreme and general Imperial necessity, or unless experience proved that the assignment made to the Province was disproportionate to its normal needs.[1]

Broadly speaking, the Government of India received the entire revenue derived from opium, salt, customs, the mint, the railways, the posts and telegraphs, the military receipts, and the tributes from Indian States. The revenues derived from registration, ordinary public works, the police, education, medical services, courts and jails, were entirely provincial. The receipts from land revenue, excise, stamps, income-tax and forests were generally divided in equal proportions between the Imperial and Provincial Governments. The bulk of the provincial revenues was derived from the divided heads.

Along with this division of revenues there was also a division of expenditure. The Central Government was responsible for all the expenditure connected with defence, the railways, the posts and telegraphs, interest on debts, and home charges. The Provincial Governments were responsible for the whole of the expenditure incurred in connection with land revenue, general administration, administration, registration, law and justice, the police, the jails, education, medical services, stationery and printing and provincial civil works. The expenditures on stamps, excise, income-tax and forests were equally divided, while the incidence of irrigation expenditure followed that of the receipts.[2]

But as the expenditure of the Provincial Governments generally somewhat exceeded the assigned revenues, the difference was made up by three methods:

(i) A fixed assignment, as formerly, under the land-revenue head.

(ii) Initial lump-sum grants granted principally with the

[1] *See* Cmd. 4360, 1908, par. 59.
[2] Cmd. 4360, par. 61.

object of enabling the Provinces to undertake works of public utility.

(iii) Special grants for the development of police reform, agriculture and education.

Another important change with regard to famine expenditure was introduced. Till 1904 the liability for famine relief was provincial and the Government of India only stepped in to help the Provinces when their resources were exhausted. Thereafter a new famine scheme was devised by which the Government of India year by year put aside a specific amount (roughly calculated with reference to the famine liabilities of each Province) on which the Provincial Governments could draw in time of famine without curtailing their normal resources. When this fund was exhausted the famine expenditure was divided equally between the Central and Provincial Governments; and in the last resort the Government of India promised further help from the Imperial revenues.[1]

On the basis of the budget figures for 1903-4 it was found that the aggregate provincial expenditure represented less than one-fourth of the total expenditure of India as a whole, while the expenditure of the Government of India (which included the expenditure for the army and the home charges) exceeded three-fourths of the aggregate. These proportions of expenditure, subject to some adjustment, were taken as the basis for the division of revenue between the Central and Provincial Governments.[2] Thus the following division of revenue and expenditure between the Central and Provincial Governments in the divided heads of revenue was decided upon:

Province	Imperial	Provincial
Bengal, United Provinces	$\frac{3}{4}$	$\frac{1}{4}$
Bombay, Madras, Punjab, Burma	$\frac{5}{8}$	$\frac{3}{8}$
Central Provinces, Assam	$\frac{1}{2}$	$\frac{1}{2}$

[1] Cmd. 4360, par. 61. In 1917 the arrangement was further simplified and famine expenditure was made a 'divided' head—the expenditure being borne by the Central and Provincial Governments in the proportion of three to one. *See* Cmd. 9109, par. 108.

[2] Some of the these adjustments were (i) larger assignments to backward Provinces, (ii) special grants for carrying out works of improvement or administrative reforms.

The Advantages of the Quasi-Permanent Settlements

The quasi-permanent settlements were a great improvement on the old system of quinquennial revisions. Under the old system the Provincial Governments were always exposed to the uncertainties and risks of an unfavourable settlement at the end of every five years. With this sword of Damocles always hanging over their heads, it was impossible to have a liberal outlook in financial policy. Any regular and systematic plan of provincial development along well-considered lines was not possible under such conditions. The new system changed this by giving the Provincial Governments a more independent position, and a more substantial and enduring interest in the management of their resources than had previously been possible.[1] The Government of India also improved its relations with the Provincial Governments by avoiding the bitter quinquennial controversies in the assignment of revenues.[2]

Permanent Settlements (1912)

The financial relations between the Central and Provincial Governments were examined by the Decentralization Commission (1909) but the Commission did not propose any radical change in the system. However, the question received the attention of Lord Hardinge's Government, and the quasi-permanent settlements of 1904 were made into 'permanent settlements' from 1912. The permanent settlements did not introduce any change in principle in the allocation of resources; except that they reduced the fixed assignments and gave the Provinces larger shares in the growing sources of revenue. These settlements continued till the Reforms of 1919 when provincial finance entered an entirely new phase.

The financial position of the Provinces during the period is shown in Tables IX, X and XI on the next three pages.

[1] *See* Cmd. 4360, 1908, par 60.

[2] In 1904-5 the settlements with the Provinces of Bengal, Madras, Assam and the United Provinces were declared to be quasi-permanent. Bombay and the Punjab obtained quasi-permanent settlements in 1905-6. In 1906 the settlement of the Central Provinces was made quasi-permanent. Burma came within the pale of quasi-permanent settlement from 1907.

Table IX

PROVINCIAL SURPLUSES AND DEFICITS

(In rupees)

Provinces	1904–5	1905–6	1906–7	1907–8	1908–9	1909–10	1910–11	1911–12
Central Provinces[1] ..	— 7,01,000	32,35,000	17,50,607	— 9,30,617	—30,97,865	7,21,755	2,80,556	12,14,573
Burma	—15,91,796	—26,13,890	18,90,516	—31,29,590	—20,50,678	25,15,371	19,00,297	12,60,040
Assam[2]	— 2,69,316	—37,20,027	—2,00,140	—25,96,682	—23,57,687	5,49,270	55,39,698	52,18,802
Bengal ..	—12,52,818	—19,52,312	—18,77,455	—22,56,994	—13,30,371	32,74,065	39,60,612	82,96,233
United Provinces ..	— 8,69,099	—28,79,192	7,95,600	—35,87,066	—10,07,260	20,45,221	36,35,904	1,44,240
Punjab	—47,94,387	—27,96,052	6,61,214	—24,08,818	15,76,981	13,00,559	41,99,121	33,98,055
Madras	—14,02,344	2,20,328	12,17,745	— 44,992	20,25,109	12,66,326	23,16,383	29,38,505
Bombay ..	—43,96,000	— 42,892	17,52,202	— 3,08,925	—26,71,996	71,37,996	75,85,460	—5,41,411

[1] Includes Berar since 1906.

[2] Eastern Bengal and Assam since 1906.

TABLE X

IMPERIAL GRANTS-IN-AID TO THE PROVINCES

(In rupees)

Provinces	1904–5	1905–6	1906–7	1907–8	1908–9	1909–10	1910–11	1911–12
Central Provinces[1] ..	28,53,710	69,57,793	1,10,550	27,52,010	29,03,668	35,88,270	34,65,500	20,80,845
Burma	5,67,500	18,45,000	72,19,900	6,82,000	2,15,253	18,20,952	42,32,742	36,05,164
Assam[2]	....	33,62,916	3,27,294	2,80,030	23,58,947	44,64,435	46,08,965	61,00,732
Bengal	24,794	48,06,984	4,75,548	13,62,634	41,57,393	57,53,692	61,37,013	1,11,31,276
United Provinces ..	1,36,600	40,36,307	76,41,697	98,79,667	87,70,345	16,24,329	45,13,729	31,36,107
Punjab	75,26,436	24,67,579	42,09,531	55,41,529	60,37,990	58,39,014	95,92,844	31,01,681
Madras	7,00,946	44,30,714	99,80,400	94,73,304	7,04,885	6,13,941	36,91,426	50,08,889
Bombay	1,03,12,928	34,27,325	40,24,512	45,74,284	57,26,162	57,97,603	1,20,09,360	49,35,159
Total ..	2,21,22,914	3,13,34,618	3,49,82,982	3,45,43,458	3,08,74,643	2,95,02,236	1,54,75,360	3,90,99,853

[1] Includes Berar since 1906.

[2] Eastern Bengal and Assam since 1906.

TABLE XI

PROVINCIAL SURPLUSES AND DEFICITS

(In rupees)

Provinces	1912–13	1913–14	1914–15	1915–16	1916–17	1917–18	1918–19
Central Provinces	50,85,246	18,81,245	—65,44,416	— 13,836	42,35,704	48,70,517	92,01,121
Burma	88,74,174	9,14,026	—37,29,808	18,96,621	94,27,702	1,20,67,708	48,73,587
Assam	36,10,494	—22,17,691	—45,50,789	6,58,812	60,44,904	28,00,634	4,35,872
Bengal	1,47,05,270	4,80,842	—39,67,607	10,28,156	37,08,838	52,80,082	7,32,237
Bihar and Orissa	70,22,199	— 9,20,062	—18,70,264	11,33,562	59,19,907	71,76,786	36,43,564
United Provinces	95,88,749	50,704	—46,11,080	— 9,73,090	34,27,808	—22,68,311	36,86,945
Punjab	74,11,069	— 6,92,512	—37,30,641	—11,33,541	5,00,995	—6,95,216	11,85,930
Madras	43,30,275	—52,98,411	—12,07,754	3,18,508	25,71,241	10,42,303	—9,72,354
Bombay	70,83,281	15,58,566	—26,39,924	— 9,51,099	1,22,434	6,11,321	16,81,066

Defects of the Permanent Settlements

With the Reforms of 1919 the basis of the financial relationship between the Central and the Provincial Governments underwent a radical change. Till 1919 there had been the 'statutory hypothecation of all Indian revenues to all-India needs.'[1] The Provincial Governments could not claim any of the revenues as entirely belonging to them, even though these revenues may have been raised within their jurisdiction. However, before we discuss the changes brought about by the Reforms, it is worthwhile mentioning some of the chief defects of the then existing system. Three defects of the system stand out prominently:

(i) The strict control and supervision by the Central Government of provincial expenditure.

(ii) The complete control by the Central Government of all taxation raised in British India.

(iii) And lastly, the Provincial Governments had no independent powers of borrowing.

The strict control exercised by the Government of India in the details of provincial expenditure was due to the fact that through all the stages of financial evolution from 1833 to 1919, the financial settlements were based not on provincial revenues but on provincial needs. This inevitably led to a close supervision from the Central Government because 'the Government of India could not allow a province to go bankrupt'.[2] Moreover, as the Government of India took a share in the divided heads of revenue, its share in the revenues depended on its own competing needs and the needs of the Provinces. Thus the Government of India had a distinct desire to keep down provincial expenditure.

Similarly, in raising revenues the Government of India had to interfere in details of provincial administration to see that its share was not diminished by the negligence or inefficiency of provincial administration. Such an arrangement was clearly incompatible with the spirit of the Reforms. 'The existing settlements', observed the authors of the Reforms, 'are an undoubted advance upon the earlier centralized system, but

[1] *See* Cmd. 9109, 1918, p. 93.
[2] Ibid., p. 92.

they constitute no more than a half-way stage. If the popular principle is to have fair play at all in Provincial Governments, it is imperative that some means be found of securing to the Provinces entirely separate revenue resources.'[1]

Again, the Provincial Governments had no independent powers of taxation. Section 79 (3) (a) of the Government of India Act (1915) prohibited a Provincial Government, without the previous sanction of the Government of India, from considering any law, affecting the public debt of India, or the customs duties or any other tax or duty for the time in force and imposed by the authority of the Governor-General in Council for the general purposes of the Government of India. A proposal for provincial taxation required the sanction of the Government of India, the approval of the Secretary of State, and the assent of the Finance Department before it could be considered by the Provincial Government. The main argument in defence of the then existing system was thus expressed in the Reforms Report (1919): 'If many buckets are dipping into one well, and drought cuts short the supply of water, obviously the chief proprietor of the well must take it upon himself to regulate the drawings.'[2] Here again, with the increased measure of independence which followed in the wake of the Reforms it was inevitable that the Provinces should be given fresh sources of income to pursue their own development policies.

Lastly, the Provincial Government had no power of borrowing in the open market—a restriction which was accepted 'as almost an axiom of the Indian financial system.'[3] It was rather an anomalous position that while Port Trusts and Corporations could raise loans on their securities, the Provincial Governments, on account of the legal fiction that the revenues of India were 'one and indivisible', could not borrow on their own account. This feature of the financial system was also changed with the introduction of the Reforms. We shall return to these matters in the next chapter.

[1] Cmd., 9109, 1918, p. 93.
[2] Ibid., pp. 93-4.
[3] Ibid., p. 94.

Conclusions

It may be asked, how far were the principles of efficiency, suitability and adequacy, observed in the financial settlements during this long period, 1833-1919? In answering this question it is good to bear in mind that the provincial financial system was closely linked with the constitutional machinery of the country. The Indian nationalistic revolt of 1857 marks the beginning of a new era in Indian constitutional and economic life. Before the Mutiny, the East India Company was engaged in conquering and consolidating the British Empire in India. The need for centralization for political and military reasons during this period was therefore paramount. The principles of public finance could not, therefore, be given full scope in the machinery of provincial finance. All that the Company was interested in was to administer the conquered territories with as great efficiency as possible. Financial problems were subordinate to military and political problems.

With the passing of the Company to the Crown, new economic and financial problems arose. During the latter half of the nineteenth century the road system was vastly improved and extended, and the construction of railways was planned and developed in a systematic way so as to serve the whole of India. The general economic development of the country resulted in an excessive financial burden on the state.[1] Hence there was a regular and heavy annual deficit which made it clear that an urgent reform of the provincial financial system was necessary. That the principles of efficiency, suitability, and adequacy could not be fully introduced was due to the fact that the entire responsibility for the raising and spending of provincial revenues could not be entrusted to Provincial Governments.[2]

However, beginning with a highly centralized system of finance, each step towards financial decentralization was marked by an effort to enlarge the powers and responsibilities of the Provincial Governments in financial administration. The history of financial devolution in India points to one

[1] At first there was no apparent chance of earning immediate profits from the railways or other works of the Public Works Department.

[2] Before 1919 legally all the revenues of the Provincial Governments belonged to the Government of India.

unmistakable conclusion, namely, that in a such continent like India, administration, whether political or financial, needs to be decentralized in the interest of efficiency. With the small beginning of budgets by 'assignments' for a few departmental heads, we passed through the system of budgets by 'assigned' revenues, 'quasi-permanent settlements' and ultimately 'permanent settlements'. At each stage a further step in financial decentralization arose out of the needs to secure efficiency, economy and responsibility. Opinions may differ as to the length of the period that each particular system lasted, but it can hardly be challenged by any critic that each step was an essential, inevitable stage in the financial devolution of the country. Moreover, it is worth remembering that though high hopes were entertained at each stage, nobody ever pretended that the system had reached the final stage.[1] Financial devolution has followed *pari passu* the constitutional development of the country. The extent of the transformation can best be realized by the fact that while before 1870 the Governor of Bengal could make 'no alteration in the allowances of public servants . . . establish a new school or augment the pay of a daroga (a police officer) to the extent of a rupee,[2] in 1919 the same authority could spend crores of rupees without any previous reference to the Government of India.

The object of the next chapter is to examine the changes brought about by the Reforms of 1919.

[1] Even Lord Curzon, who always entertained very high hopes from his arrangements, on the occasion of the budget debate in the Imperial Legislative Council (1904) used the following guarded language on the financial settlement of 1904: 'These new settlements constitute, in my view, the most important step in the nature of decentralization that has been adopted for many years, and will, I hope, be the forerunner of others in the future.' *See* Proceedings of the Governor-General's Legislative Council, March 30, 1904, p. 547 (India Office Library).

[2] *The Calcutta Review*, Vol. III, 1955, p. 170.

III

THE MONTAGU-CHELMSFORD REFORMS

§ 1. *THE CONSTITUTIONAL BASIS*

The Introduction of Limited Responsible Government

On August 20, 1917, Mr. Montagu, the Secretary of State for India, announced that the policy of His Majesty's Government was that of increasing the association of Indians in every branch of administration and the gradual development of self-governing institutions with a view to the progressive realization of responsible government in India as an integral part of the British Empire.[1] In consonance with this view Mr. Montagu visited India in November, 1917, and the Montagu-Chelmsford Report on Constitutional Reforms was issued on April 22, 1918.[2] After a most elaborate examination of the Report by the Joint Select Committee of the two Houses of Parliament which sat on the Reforms Bill, the Government of India Act, 1919, was passed.

The Reforms mark the end of an epoch and the beginning of a new one. Before the Reforms India was ruled by an absolute system of Government, the Provincial Governments being subordinate to the Central Government in the executive, financial and legislative spheres, whilst the Central Government itself was under the control of the Secretary of State for India in these matters. Besides this, the Provincial Governments were not responsible to the Provincial Legislatures. A really responsible Government could not be introduced in the Provinces without completely changing these relations. Thus, the first thing which the authors of the Reforms aimed at was the curtailment of the powers of the Government of India over Provincial Governments in legislative, financial and administrative matters. The authors of the Joint Report well observed:

> 'We have to demolish the existing structure, at least in part, before we could build the new. Our business is one of

[1] *Report on Indian Constitutional Reform*, Cmd. 9109, 1918, p. 5.
[2] Cmd. 9109.

devolution, of drawing lines of demarcation, of cutting long-standing ties. The Government of India must give and the Provinces must receive; for only so can the growing organism of self-government draw air into its lungs and live.'[1]

'Central' and 'Provincial' Subjects, 'Reserved' and 'Transferred' Subjects

The Reforms introduced limited responsible government in the Provinces. It classified subjects into 'central' and 'provincial'. Among the important central subjects were military matters, foreign affairs, tariffs and customs, the railways, the posts and telegraphs, income-tax, currency, coinage and public debt, commerce and shipping, and civil and criminal law.[2]

To introduce a measure of limited responsibility, provincial subjects were classified as 'reserved' and 'transferred'. The reserved subjects included land revenue, the police, prisons, factory inspection, labour affairs in general, and the administration of justice. In the transferred subjects were placed local self-government, education, sanitation, public health, hospitals, asylums, public works, the development of industries, agriculture, veterinary questions and co-operative societies. Broadly speaking, the administration of justice, law and order, and the preservation of financial stability were reserved subjects, and what are loosely called the 'nation-building' departments were transferred.

The Administration of Transferred and Reserved Subjects

The administration of the transferred subjects was placed under the charge of ministers chosen by the Governor from among the elected members of the Provincial Legislative Council. The ministers, together with the Governor, administered these subjects. Under the Act[3] the Governor was to be

[1] Cmd. 9109, 1918, p. 101.

[2] The actual division of subjects was carried out by the Devolution Rules made under section 45A of the Government of India Act, 1919. The Devolution Rules delimited the provincial field in legislative, administrative and financial matters. The rules were issued as Cmd. 891 of 1920.

[3] Section 52 (1) and (2).

guided in relation to these subjects by the advice of his ministers unless he thought that their policy would adversely affect the interests of race, religion, education and other subjects. In such cases he could disregard their advice, and if the ministers did not act according to his advice he could himself assume charge of the subject.[1] He could also sanction any expenditure necessary for any department or for the maintenance of the peace and tranquillity of the Province.

The position of the Governor *vis-a-vis* the ministers was subject to severe criticism by both the ministers and the Councils.[2] Thus it was said that the ministers had no real power and were constantly overruled by the Governor. Indeed, it was said that the Governor ran the transferred departments as well as the reserved departments. On the other hand there is evidence that the Governor's relations with his ministers were harmonious. 'We have it on record that in one Province the Governor's power of overruling the ministers was never used at all; in another a minister asserted that during the eight years he was minister, there had not been a single occasion when he had been overruled by the Governor.'[3]

Perhaps both these views are extreme views. Appadorai is correct when he says that 'the Governor's experience, and the prestige attaching to his position often enabled him to deflect the course of administration and to have a real voice in the affairs of the transferred half. He maintained a central position not always merely as arbiter or reviser, but as the final repository of administrative experience.'[4] If we accept dyarchy as a transitional stage to full responsible government, the position of the Governor *vis-a-vis* the ministers is, I think, the logical outcome of such an arrangement.

The reserved subjects were administered by the Governor and his Executive Council. The Governor normally presided over the meetings of the Executive Council and in case of any difference of opinion the decision of the majority prevailed, subject to the qualification of the provision under section 50(2).

[1] The defects of dyarchy are discussed in Ch. IV.
[2] *See* Appadorai, A., *Dyarchy in Practice*, Longmans, 1937, Ch. VIII.
[3] Ibid., p. 233.
[4] *See* Cmd. 3568, 1930, p. 302.

The position of the ministers was that they were members of the Executive Government but not of the Executive Council. They held office not at the will of the Council but during the Governor's pleasure.[1] The Legislature, however, could censure their administration, reduce their salaries and refuse supplies.[2] The ministers had then to satisfy two masters, the Legislature and the Governor, and in some cases could satisfy neither.

The Principle of Joint Responsibility

Within the limits of transferred subjects the principle of joint ministerial responsibility was the intention of the Joint Report. The principle, however, was nowhere mentioned in the body of the Act. Yet in the working of the Provincial Councils it was recognized by the ministers in Madras, the United Provinces and Bengal. It was largely dependent upon the personal equation of the ministers.[3]

This system of government in the Provinces was popularly called Dyarchy.[4]

Local Self-Government

Besides these changes in the administration of the Provincial Governments, the Reforms laid emphasis on the development of local self-government.[5] After reviewing the history of local self-government and the constitution of local bodies as it existed then (1919), the Indian Statutory Commission remarked that, outside a few municipalities, there was in India nothing that we should recognize as local self-government of the British type before the era of the Reforms.[6] It is of the

[1] Cmd. 5368, 1930, p. 235.

[2] In the Central Provinces in 1924-25, the ministers' salaries were fixed at the farcical figure of Rs. 2 per annum. The Swarajist majority also refused all the supplies which lay in its power to vote. See *Moral and Material Progress of India*, Government of India Press, Delhi, 1924-25, p. 304.

[3] *See* Ch. IV for joint responsibility.

[4] In Bengal in August, 1929, the Provincial Council passed a vote of no-confidence against Mr. (later Sir) A. K. Ghaznavi. Mr. Chakravarti, on the principle of joint responsibility, resigned as well. The Bengal Council refused to recognize the principle of joint responsibility and passed a separate resolution of no-confidence against Mr. Chakravarti in spite of his assurance that he would resign on account of the no-confidence motion against Mr. Ghaznavi.

[5] The problems of local taxation are discussed in Ch. XX.

[6] *See* Cmd. 3568, 1930, 302.

highest importance to bear this in mind when appraising the changes introduced by the Reforms.

The authors of the Joint Report in formulating the principles for the realization of responsible government laid down as their first formula that: There should be, as far as possible, complete popular control in local bodies and the largest possible independence for them from outside control.[1]

Translating this into practice they suggested an elected majority on all boards, the replacement of official chairmen by elected non-officials on municipalities and, where possible, on district boards. The enlargement of the elected element was to be through the extension of the franchise to make constituencies really representative of the general body of ratepayers. The Report in particular laid stress on the advisability of fostering village government by panchayats. It recommended that panchayats might be endowed with civil and criminal jurisdiction in petty cases, some administrative powers as regards sanitation and education, and permissive powers of imposing a local rate.[2]

Since the Reforms, local self-government both in cities and rural areas, though in some cases showed signs of deterioration, made considerable progress. Generally speaking, the functions entrusted to municipalities are the administration of education, public health, sanitation, medical relief and public works, including roads and bridges. Similarly, district boards control rural education, dispensaries, sanitation, country roads, bridges, water supply, ponds, fairs, ferries and *sarais* (rest-houses).

Municipalities enjoyed a considerable measure of freedom with regard to taxation.[3] Draft rules under section 10(3) (a) of the Government of India Act, 1919, empowered the Legislative Council of a Province to make and take into consideration without the previous sanction of the Governor-General any law imposing or authorizing any local authority to impose for local purposes the following taxes:

(1) A toll

[1] *See* Cmd. 9109, 1918, p. 155.
[2] *See* Cmd. 9109, 1918, p. 161.
[3] The main sources of income of district boards is a tax or cess on the annual value of land. They also receive grants from the Provincial Governments for particular services. *See* Ch. XX.

(2) A tax on land or land values
(3) A tax on buildings
(4) A tax on vehicles or boats
(5) A tax on animals
(6) A tax on menials and domestic servants
(7) An octroi
(8) A terminal tax on goods imported into local areas on which an octroi was levied on or before July 6, 1917
(9) A tax on trades, professions and callings
(10) A tax on private markets
(11) A tax imposed in return for services rendered, such as:
   (a) a water rate,
   (b) a lighting rate,
   (c) a scavenging, sanitary or sewage rate,
   (d) a drainage rate,
   (e) fees for the use of markets and other public conveniences.[1]

The Government's control over local authorities in financial matters was limited. It could, however, alter their budgets if it considered that they had not made due provision for loan charges for the maintenance of a working balance or, in other cases, of gross financial negligence. It could also intervene in the administration of local authorities by preventing or initiating action in matters affecting human life, health, safety or public tranquillity. But these powers were very infrequently exercised.[2]

§2. *THE CHANGES IN THE FINANCIAL SYSTEM*

Abolition of Divided Heads

An essential feature in the political development of a country is the extent of growth in the control over the finances by the people. In Chapter II we have seen that one of the defects of the financial system before the Reforms was the absolute control and interference of the Central Government in provincial financial matters. It would have been ridiculous to introduce provincial autonomy without separating the resources

[1] *See* Cmd. 891, 1920, pp. 36-7.
[2] *See* Cmd. 3568, 1930, p. 305.

of the Central and Provincial Governments, because the existing system of divided heads meant joint control and interference from the centre. The authors of the Report rightly observed:

> The present settlements by which the Indian and Provincial Governments share the proceeds of certain heads of revenue, are based primarily on the estimated needs of the Provinces, and the Government of India disposes of the surplus. This system necessarily involves control and interference by the Indian Government in provincial matters. An arrangement which on the whole worked successfully between two official governments would be quite impossible between a popular and an official government.[1]

It was most important that such troubles should be avoided and the best way to do it was to give the Provinces separate resources. Hence as a preliminary to constitutional reforms the authors of the Report proposed the separation of the central and provincial finances. It was justly remarked in the Report that if provincial autonomy was to mean anything real, the Provinces must not be dependent on the Indian Government for their means of development.[2]

'Imperial' and 'Provincial' Sources of Revenue

To this end, Mr. Montagu and Lord Chelmsford proposed to hand over to the Provinces the entire financial responsibility—both in revenue and expenditure[3]—of certain provincial subjects. They abolished the old system of 'divided' heads of revenue. Land revenue, irrigation, excise, forests, and judicial stamps were entirely transferred to the Provinces; while customs, commercial stamps, receipts from the railways, salt, opium, and the posts and telegraphs were to remain wholly

[1] Cmd. 9109, 1918, p. 104.

[2] The authors remarked: 'Our first aim has therefore been to find some means of entirely separating the sources of the Central and Provincial Governments.' Cmd. 9109, 1918, p. 164.

[3] The separation, however, was not complete, because the Provinces had to contribute a portion of their revenues to the Central Government. I think it hardly need be complete. The 'permanent settlements' before the Reforms provided only for the ordinary growth of expenditure, but for large and costly programmes the Provincial Governments had to depend on the doles out of the Indian surplus. *See* Ch. II.

central heads of revenue.[1] As a result of this re-arrangement the Central Government was faced with a heavy annual deficit of Rs. 9.5 crores and the Provincial Governments gained Rs. 18.5 crores of additional annual revenue. How to make up this deficit was the chief difficulty of the Committee.

Difficulties in Equitable Provincial Financial Settlements

To remove the deficit the authors of the Report proposed a system of contributions from the Provinces.[2] It was in assessing these contributions that they met with various obstacles on account of the disparity which existed between one province and another in the extent of their revenue and scales of expenditure due to inequalities of treatment in past financial settlements.[3]

Apart from such minor difficulties, the unequal economic development of the country was and must always be the most serious handicap in the distribution of resources. India is a large sub-continent. Some parts of the country are better fitted for industrial advancement on account of the presence of raw materials, sources of power, and of their better geographical position and improved means of transportation and communication. The huge disparity in economic development and financial resources between industrially advanced provinces like Bombay and Bengal, and agricultural provinces like the United Provinces and the Punjab, or the Provinces of Bihar, Orissa and Assam, cannot be corrected by any redistribution of resources even by the most ingenious finance minister. Moreover, the artificial division of the country into various provinces, due to the haphazard growth of British power in India, places insurmountable difficulties in the way of an equitable financial adjustment between the various provinces. In a centralized system of financial allocation and administration, the artificial provincial boundaries were of less importance. But when each Provincial Government, as a result of political advancement, is made responsible for its own revenue and expenditure, such maldistribution of areas

[1] For a complete list see *Indian Year Book*, Times of India, 1920, pp. 691 ff.

[2] The power to levy such contributions was laid down in S. 112 of the Government of India Act, 1919.

[3] *See* Ch. II.

into artificial self-contained units creates additional problems, which are not capable of easy and simple solution. In India there can never be an absolute equality of treatment of the Provinces in financial resources and adjustments. The aim of the financier must be to minimize such natural and artificial inequalities of burdens and resources to as large an extent as possible in the light of the broad principles of public finance.[1]

Provincial Contributions

The authors of the Report were presented with many a plan for removing the central deficit and minimizing inequalities of provincial financial burdens and resources.[2] Their ultimate choice fell upon a system of contributions from each province based on 'a percentage of the difference between the gross provincial revenue and the gross provincial expenditure'[3] that each province would enjoy under the new allocation of resources. On the basis of the budget figures for 1917-18 (subject to some adjustments) the deficit in the Government of India budget was estimated to be Rs. 1,363 lakhs. The estimated gross provincial surplus (after deducting normal expenditure of all provinces) was Rs. 1,564 lakhs. This left a net surplus of Rs. 201 lakhs available for provincial distribution.[4] Accordingly, each Provincial Government, it was proposed, should contribute 87 per cent of the difference between the gross provincial revenue and the gross provincial expenditure. The provincial contributions and the net

[1] *See* Ch. I and Appendix I.

[2] The various alternative proposals examined by the authors were as follows: 'One way of meeting it would be to maintain the basis of the present settlements, but to allot to the Government of India a certain proportion of growing revenue instead of its share of the divided heads. But this device would stereotype all the existing inequalities between the Provinces which by reason of the permanent settlement in some of them are considerable while it would also introduce an element of great uncertainty into the Indian Government's finance. A second was that we should take an all round contribution on a per capita basis. But this expedient also would not obviate very undersirable variations between provinces in the rate of levy owing to the inequality of provincial resources and of provincial needs. A third plan was to take an all-round percentage contribution based on gross provincial revenue. This is open, *inter alia*, to the objection that it would leave several of the proposal that provinces which had a surplus should temporarily help others as being cumbrous and impracticable.' Cmd. 9109, 1918, p. 168.

[3] The estimated provincial expenditure included provision for famine relief and protective irrigation. Both these heads were transferred to the Provincial Governments.

[4] i.e. 13 per cent of the gross available surplus.

provincial surpluses, according to the above principle, are given in the following table.[1]

TABLE XII

(In lakhs of rupees)

Provinces	Gross Provincial revenue	Gross Provincial Expenditure	Gross Provincial Surplus	Contribution (87 per cent of col. 4)	Net Provincial Surplus
Madras ..	13,31	8.40	4,91	4,28	63
Bombay ..	10,01	9,00	1,01	88	13
Bengal ..	7,54	6,75	79	69	10
United Provinces ..	11,22	7,47	3,75	3,27	48
Punjab ..	8,64	6,14	2,50	2,18	32
Burma ..	7,69	6,08	1,61	1,40	21
Bihar and Orissa ..	4,04	3,59	45	39	6
Central Provinces ..	4,12	3,71	41	36	5
Assam ..	1,71	1,50	21	18	3
Total ..	68,28	52,64	15,64	13,63	2,01

The authors of the Report, however, admitted the inequality of the burdens and recommended that after ten years' experience of the working of the system the whole question of provincial contributions should be reinvestigated by the Statutory Commission proposed by them.[2]

Criticism of the Basis of the Provincial Contributions

These proposals were severely criticised by the Provincial Governments. The method of assessing the provincial contributions was regarded as highly unfair. The *prima facie* injustice of the scheme can be seen at a glance from the

[1] *See* Cmd. 9109, 1918, p. 169.

[2] The weighty words of the authors have not received due consideration at the hands of their critics. The authors fully realized the limitations of their proposals when they wrote, 'We have, for the present, accepted the inequality of burden which history imposes on the Provinces because we cannot break violently with traditional standards of expenditure, or subject the permanently-settled Provinces to financial pressure which would have the practical result of forcing them to reconsider the permanent settlement.' Cmd. 9109, 1918, pp. 170, 171.

percentages which the contributions would have borne to the net provincial revenues.[1]

Madras	..	..	..	47.7 per cent
United Provinces		..	..	41.1 per cent
Bengal	..	..	..	10.1 per cent
Bombay	..	..	..	9.6 per cent

This would have meant that the richest as also the most economical province would have paid the most while the most extravagant province would have paid the least. It would have penalized thrift and encouraged extravagance. In other words, it was really equivalent to putting a premium on extravagance and inefficiency.

The inequality of the treatment seemed to be so apparent that the Government of India in their dispatch of March 5, 1919, pressed for an early treatment of the matter. They proposed the appointment of a committee to advise on the financial relations between the Central and Provincial Governments. This recommendation of the Government of India was accepted by the Joint Select Committee of the Houses of Parliament, and the Financial Relations Committee with Lord Meston as its Chairman was appointed in January, 1950.[2]

The Meston Committee

The allocation and distribution of financial resources between the Central Government and the Provincial Governments between 1921-2 and 1936-7, were primarily based on the recommendations of the Meston Committee.[3] A careful study of the Report is extremely important in view of the new basis which the Committee adopted for the fixing of provincial contributions. These contributions, popularly known as the 'Meston Award', were largely responsible for the financial

[1] i.e. gross provincial revenue minus provincial contributions.

[2] Cmd. 724, 1920.

[3] The Meston Committee was to advise on:

(i) The contributions to be paid by the various Provinces to the Central Government for the financial year 1921-22.

(ii) The modifications to be made in the provincial contributions thereafter with a view to their equitable distribution until there ceases to be an all-India deficit.

(iii) The future financing of the provincial loan account.

(iv) Whether the Government of Bombay should retain any share of the revenue derived from income-tax. Cmd. 724, 1920, par. 3.

stringency in the early years of the working of the Reformed Councils.

The Committee did not favour the distribution of the income-tax proceeds among the Provinces for the two strong reasons advanced in the Joint Report—first, the necessity of maintaining a uniform rate throughout the country, and secondly, the difficulty of finding out the exact locale of the tax, as in the case of ramifying enterprises the Province where the tax was paid was not necessarily the Province where the tax was earned.

The authors of the Joint Report had divided stamps into two classes—general stamps and judicial stamps: the former they had allocated to the Central Government, the latter to the Provincial Governments. The Meston Committee, in order to help the poorer Provinces, recommended that general stamps should be provincialized. This, they thought, would also remove the last 'taint of a divided head'. Moreover, such an arrangement would facilitate the control and collection by the same agency.

The Meston Award

As a result of the above recommendations for the allocation of the heads of revenue and expenditure between the Central and Provincial Governments, the Committee estimated a deficit of 9.83 crores in the Central budget for the year 1921-22.[1] The actual distribution of the deficit among the Provinces presented various difficulties to the Committee. The Committee found that the scheme of contributions proposed in the Joint Report, namely assessment proportionate to the gross surplus,

[1] (i) Six crores was the deficit previously estimated by the Government of India: to this four crores was added for the loss of general stamps.

(ii) In arriving at the above figure two important adjustments were made:

(*a*) The Burma Government had represented that as 68 per cent expenditure on military police in the Province was incurred for frontier defence, the amount ought to be debited to the Central budget. The Committee accepted this view and recommended that Rs. 17.42 lakhs only should be charged to the Province on this account.

(*b*) The main adjustments, however, were concerned with the payment of pensions. Before the Reforms all civil pensions paid outside India were debited to the Central Government whether the pensioner had served in the Imperial Department or in the Provinces. The Provincial Governments were not charged for such pensions. The Committee recommended that henceforward all pensions paid outside India should be debited to the province where the pensioner had served. Similarly, the Government of India should pay its own pensioners. Cmd. 724, 1920, par. 10.

was unfair and they accordingly dropped it. The authors of the Joint Report had considered both revenue and expenditure in fixing the contributions. Herein lay the main difficulty. While the normal revenue figures arrived at the Simla conference, on the basis of which the contributions were fixed, were generally accepted by the Provinces, the estimates of normal expenditure were strongly contested. The Committee were faced with certain contentious questions like: How much of the expenditure held over during the war, or clearly imminent if not already sanctioned, ought to be included in the calculation of normal expenditure? Where is the dividing line to be drawn between expenditure essential in the immediate future, and expenditure foreseen as a future commitment? Ought a province to be penalized by an increase in its contribution for strict adhesion to economy during the war, while another province, which had increased its expenditure more freely, is rewarded by a reduced contribution? Is adequate allowance made for the special conditions of a largely undeveloped province like Burma, or for the circumstances of a recently established province like Bihar and Orissa, which claims that it has never received from its beginning resources adequate to its needs?[1] To these questions the Committee could find no satisfactory answers.

Initial Contributions

The Committee, in fixing the initial contribution, made an important departure from the principle laid down by the Joint Report. They dropped altogether the considerations of expenditure in fixing the contributions. They fixed the contributions on a new principle, namely that of the increased spending power of each province under the new allocation of resources. The Committee, however, in applying this principle placed before it two broad considerations:

(i) That each province must be left with a certain reasonable working surplus.

(ii) That in no case should the contribution be such as to force the province to embark on new taxation ad hoc.[2]

[1] *See* Cmd. 724, 1920, par. 13.
[2] Cmd. 724, 1920, par 11.

In view of the above two limiting considerations the initial contributions were in some measure arbitrarily dictated by the existing financial position of each province and not by an equitable standard such as the capacity to pay.[1] Hence the Committee considered the case of each province on its merits and recommended the following assessments, which were accepted by the Joint Select Committee.[2]

TABLE XIII

INITIAL CONTRIBUTIONS

(In lakhs of rupees)

Provinces	Increased spending power under new distribution of revenue	Contributions recommended by the Committee	Increased spending power left after contributions are paid
Madras ..	5,76	3,48	2,28
Bombay ..	93	56	37
Bengal ..	1,04	63	41
United Provinces ..	3,97	2,40	1,57
Punjab ..	2,89	1,75	1,14
Burma ..	2,46	64	1,82
Bihar and Orissa ..	51	Nil	51
Central Provinces ..	52	22	30
Assam ..	42	15	27
Total ..	18,50	9,83	8,67

[1] 'In making our recommendations as to the initial contributions we have had to consider established programmes of taxation and expenditure, and legislative and administrative expectations and habits, that cannot without serious mischief be suddenly adjusted to a new and more equitable ratio of contribution widely different (as an equitable ratio admittedly be) from that of the past. It is accordingly inevitable, if such mischief is to be avoided, that the ratio for initial contributions should bear little relation to that which would be ideally equitable. But an initial ratio of this nature can only be defended as a measure of taxation.' Ibid. par. 23.

[2] In fixing these contributions, Burma, Bihar and Orissa, the Central Provinces and Assam received special consideration. Burma was lightly assessed on account of its backward condition. No contribution was recorded for Bihar and Orissa for 1921-22 as the Province was the poorest in India in its revenue resources. The Central Provinces and Assam were assessed at 40 per cent because they had a small margin. Bombay, Bengal the United Provinces and Madras were equally treated and were required to pay 60 per cent of their spending power. Ibid. pars. 18, 19, 20.

[3] Cmd. 724, 1920, par. 17.

Standard Contributions

The initial contributions, which were only transitional, were not considered by the Committee as ideally equitable. In their opinion the standard contributions were to be based on a more satisfactory, equitable and certain basis. They observed that 'to do equity between the Provinces it is necessary that the total contribution of each province to the purse of the Government of India, should be proportionate to its capacity to contribute'.[1]

In translating this principle into practice the Committee were faced with two important considerations. What were the total contributions of a province to the revenues of the Central Government? Secondly, and a more difficult question, what were the capacities of the provinces to contribute? With regard to the first question one Committee observed that 'the total contribution of a province to the purse of the Government of India will consist in future of its direct contribution towards the deficit, together with its indirect contribution (as at present) through the channels of customs, income-tax, duties on salt, etc.[2]

Turning to the second question of an equitable distribution, the Committee stated that 'the capacity of a Province to contribute is its taxable capacity, which is the sum of the income of the tax payers or the average income of its taxpayers multiplied by their number.'[3]

An evaluation of the amounts of indirect contributions attributable to each province involves an exact arithmetical calculation for which adequate statistical information was not available. Moreover, such information as was available could not be of much use for, e.g. under the head of customs the locality in which the revenue was collected was, surely, not the locality in which the articles were consumed. Similarly, under income-tax, questions of the utmost complexity

[1] Cmd. 724, 1920, par. 24.

[2] Cmd. 724, 1920, par. 25. The Committee here were considering the claims of industrial provinces like Bombay and Bengal which contributed the largest share to the Central revenues through customs and income-tax. This question is discussed in Ch. IV.

[3] Ibid. par. 26. In fixing the second principle the Committee had in mind the claims of poorer provinces like Assam, Bihar and Orissa, whose resources had not fully developed and whose capacity to pay was small.

arise, such as the fact that the place where the tax is collected is not the true source of its origin. The Committee rightly did not place too much reliance on these factors and in fixing the standard contributions gave due weight to 'the more general circumstances of the economic life of the Provinces.'

The Committee therefore applied the concept of taxable capacity by fixing the contributions with great caution. I cannot do better than quote at length the view of the Committee in this matter. They observed that:

> We are able, after surveying such figures as are available and after close inquiry into the circumstances of each province, to recommend a fixed ratio of contribution of the burden of any deficit. In arriving at this ratio we have taken into consideration the indirect contributions of the Provinces to the purse of the Government of India, and in particular the incidence of customs duties and of income-tax. We have inquired into the relative taxable capacities of the Provinces, in the light of their agricultural and industrial wealth and of all other relevant incidents of their economic positions, including particularly their liability to famine. It should be observed that we have considered their taxable capacities not only as they are at the present time, or as they will be in the immediate future, but from the point of view also of the capacity of each province for expansion and development agriculturally and industrially, and in respect of imperfectly developed assets such as minerals and forests. We have also given consideration to the elasticity of the existing heads of revenue which will be secured to each province, and to the availability of its wealth for taxation.[1]

After estimating, to the best of their ability, the weight which should be given to each of the circumstances mentioned above, the Committee recommended the following fixed ratio of standard contribution which each province should

[1] Cmd. 724, 1920, par. 27. I have quoted at length the view of the Committee to prove later on that the principles on which the 'award' was based were not unsound. It was the political machinery and the economic conditions of the times which condemned them. *See* Ch. IV.

pay to meet the deficit in the budget of the Government of India:

STANDARD CONTRIBUTIONS[1]

Provinces	Percent contribution to deficit
Madras	17
Bombay	13
Bengal	19
United Provinces	18
Punjab	9
Burma	6½
Bihar and Orissa	10
Central Provinces	5
Assam	2½
	100

The Committee, in order to avoid sudden dislocation in provincial budgets, further safeguarded their findings by requiring an interval of seven years to enable the provinces to adjust their budgets to new conditions. The initial, intermediate and ultimate rations of contributions as recommended by the Committee are given in the following table:[2]

TABLE XIV

	1st Year	2nd Year	3rd Year	4th Year	5th Year	6th Year	7th Year
Madras	35½	32½	29½	26½	23	20	17
Bombay	5½	7	8	9½	10½	12	13
Bengal	6½	8½	10½	12½	15	17	19
United Provinces	24½	23½	22½	21	20	19	18
Punjab	18	16½	15	13½	12	10½	9
Burma	6½	6½	6½	6½	6½	6½	6½
Bihar and Orissa	nil	1½	3	5	7	8½	10
Central Provinces	2	2½	3	3½	4	4½	5
Assam	1½	1½	2	2	2	2	2½
Total	100%	100%	100%	100%	100%	100%	100%

[1] Cmd. 724, 1920, par. 27.
[2] Cmd. 724, 1920, par. 28.

Changes made by the Devolution Rules

These recommendations of the Committee were severely criticized by the public and the Provincial Governments, whose views were invited by the Government of India.[1] The Secretary of State and the Government of India, however, accepted them. The Joint Select Committee of Parliament, in view of the loud protests of the Provincial Governments, made some changes in revising the Draft Rules made under the Government of India Act, 1919.[2] Accordingly the Devolution Rules provided:

(15) There shall be allocated to each Local Government a share in the income-tax collected under the Indian Income-tax Act, 1918, within its jurisdiction. The share so allocated shall be three pies on each rupee brought under assessment under the said Act, in respect of which the income-tax assessed has been collected. The number of pies to be specified shall be so calculated as to yield at the outset to the Local Governments collectively a sum amounting as near as may be to 400/- lakhs.

(17) In the financial year 1921-2 contributions shall be paid to the Governor-General in Council by the Local Governments mentioned below according to the following scale:

Name of Province	Contribution (In lakhs of rupees)
Madras	3,48
Bombay	56
Bengal	63
United Provinces	2,40
Punjab	1,75
Burma	64
Central Provinces and Berar	22
Assam	15

(8) From the financial year 1922-23 onwards a total contribution of 9,83 lakhs, or such smaller sum as may be determined by the Governor-General in Council, shall be

[1] The views of the Government of India and the Local Governments are published in Cmd. 974, 1920.
[2] Section 45 A, Cmd. 891, 1920.

paid to the Governor-General in Council by the Local Governments mentioned in the preceding rule. When for any year the Governor-General in Council determines a smaller sum than that payable for the preceding year, a reduction shall be made in the contributions of those Local Governments only whose last previous annual contribution exceeds the proportion specified below of the smaller sum so determined as the total contribution; and any reduction so made shall be proportionate to such excess:

Madras	17/90ths
Bombay	13/90ths
Bengal	19/90ths
United Provinces	19/90ths
Punjab	9/90ths
Burma	6½/90ths
Central Provinces and Berar	5/90ths
Assam	2½/90ths

Provincial Loan Account

A few more changes, introduced by the Reforms, to complete the separation between the provincial and central finances need our attention at this stage. First, it was commonly agreed that the Provincial Loan Account should be closed and the Provinces should in future finance their own loan transactions.[1] On the basis of the recommendations of the Financial Relations Committee it was provided by Rule 23 of the Devolution Rules that:

> Any moneys which, on the 1st day of April, 1921, are owed to the Governor-General in Council on account of advances made from the Provincial Loan Account of any Province shall be treated as an advance to the Local Government from the revenues of India, and shall carry interest at a rate calculated on the average rate carried by the total amount owed to the Governor-General in Council on this account on the 31st March, 1921. The interest shall be payable upon such dates as the Governor-General in Council may fix. In addition the Local Government shall

[1] Cmd. 724, 1920. Ch. VI, Provincial Loan Account.

pay to the Governor-General in Council in each year an instalment of the principal amount of the advance, and this instalment shall be so fixed that the total advance shall, except where for special reasons the Governor-General in Council may otherwise direct, be repaid before the expiry of twelve years. It shall be open to any Local Government to repay in any year an amount in excess to the fixed instalment.[1]

Irrigation under the Reforms

Irrigation under the Reforms scheme, was a provincial reserved subject. It would have been incompatible, under the scheme, to make the Government of India responsible for such expenditure and to hand over the control to the Provincial Governments. Hence Devolution Rule 24 provided that:[2]

(i) The capital sums spent by the Governor-General in Council upon the construction in the various Provinces of productive and protective irrigation works and of such other works financed from loan funds as may from time to time be handed over to the management of Local Government shall be treated as advances made to the Local Governments from the revenues of India. Such advances shall carry interest at the following rates, namely:

(*a*) In the case of outlay up to the end of the financial year 1916-17, at the rate of 3,3252 per centum.

(*b*) In the case of outlay incurred after the financial year 1916-17, at the average rate of interest paid by the Governor-General in Council on loans raised in the open market since the end of that year.

(ii) The interest shall be payable upon such dates as the Governor-General in Council may fix.

Provincial Borrowings

Prior to the Reforms, as we have already noticed, the power of borrowing was not conceded to the Provinces. The authors of the Reforms clearly recognized that if Provincial

[1] Cmd. 891, 1920.
[2] Cmd. 891, 1920.

Governments were to enjoy such a real measure of independence as would enable them to pursue their own development policy, they must be given some powers of raising loans on the security of their resources. Consequently the Local Government Borrowing Rules, made under the Government of India Act, provided that, subject to certain conditions.[1]

A Local Government may raise loans on the security of the revenues allocated to it for any of the following purposes:

(*a*) To meet capital expenditure on the construction or acquisition (including the acquisition of land, maintenance during construction and equipment) of any work or permanent asset of a material character in connection with a project of lasting public utility, provided that:

(i) the proposed expenditure is so large that it cannot reasonably be met from current revenues, and

(ii) if the project appears to the Governor-General in Council unlikely to yield a return of not less than such percentage as he may from time to time by order prescribe, arrangements are made for the amortization of the debt;

(*b*) to meet any classes of expenditure on irrigation which have under the rules in force before the passing of the Act been met from loan funds;

(*c*) for the giving of relief and the establishment and maintenance of relief works in time of famine or scarcity;

(*d*) for the financing of the Provincial Loan Account; and

(*e*) for the repayment or consolidation of loans raised in accordance with these rules or the repayment of advances made by the Governor-General in Council[2] (Section 2).

[1] *See* Cmd. 891, 1920.

[2] These rules were subject to the following two conditions: (1) No loan shall be raised by a Local Government without the sanction (in the case of loans to be raised in India) of the Governor-General in Council, or (in the case of loans to be raised outside India) of the Secretary of State in Council, and in sanctioning the raising of a loan the Governor-General in Council or the Secretary of State in Council, as the case may be, may specify the amount of the issue and any or all of the conditions under which the loan shall be raised. (2) Every application for the sanction of the Secretary of State shall be transmitted through the Governor-General in Council. Cmd. 891, 1920, Section 3.

'Scheduled Taxes'

The authors of the Report clearly saw that for the growth of real provincial autonomy the Provincial Governments must be allowed to impose taxes without the previous sanction of the Government of India. Hence by the rules made under the Reforms Act it was provided that:[1]

> The Legislative Council of a Province may, without the previous sanction of the Governor-General, make and take into consideration, any law for imposing for the purpose of the Local Government any tax included in Schedule I.[2]
> This schedule comprised the following heads of taxation:
>
> (1) A tax on land put to uses other than agricultural.
> (2) A tax on succession or acquisition by survivorship in a joint family.
> (3) A tax on any form of betting or gambling permitted by law.
> (4) A tax on advertisements.
> (5) A tax on amusements.
> (6) A tax on any specified luxury.
> (7) A registration fee.
> (8) A stamp duty other than duties of which the amount is fixed by Indian legislation (Schedule I[3])

In other cases the previous sanction of the Governor-General in Council was necessary.

Provincial Budgets

Finally, as a result of the proposed separation of revenues a complete separation of the central and provincial budgets came in. Before the Reforms the budget of the Government of India included the transactions of all the Provincial Governments as well. Henceforward, the provincial budget instead of being passed by the Finance Department of the Government of India, was framed by the Finance Department of each province.

Thus was cut the financial, administrative and legislative

[1] Rules under s. 10 (3), (*a*) of the Government of India Act, 1919, Scheduled Taxes Rules. Cmd. 891, 1920.
[2] Section 2.
[3] Cmd. 891, 1920.

strand which had so far blocked the path for the growth of provincial autonomy in India.

Conclusions

The Reforms mark the end of the old era and the beginning of a new one. With the introduction of limited provincial autonomy the Central Government's legislative, administrative and financial control in provincial matters decreased considerably. The Provincial Governments were given real freedom to work the Reforms in a limited sphere. The transfer of financial control was perhaps the greatest line of advancement. Nevertheless, the Reforms were regarded as a niggardly gift and a sham. The critics 'termed them a dress giving only the trappings of reality to a dead body which had neither life nor force'.[1]

This, however, is an extremely shallow view of the Reforms. Every student of Indian problems, whatever his prepossessions, must be driven by the inexorable force of facts to recognize that the Reforms were a transitional stage in the constitutional evolution of the country. From the Reforms did emerge a steady, though slow, process of administrative devolution from the Government of India to the Provincial Governments, which has profoundly affected the whole course of India's future constitution. This gradual devolution produced three important results. 'It had tended to remove provincial administration from the immediate purview of His Majesty's Government and, by thus weakening the direct accountability of Indian administrators to Parliament, it had, perhaps, rendered inevitable the introduction, in some degree, of local responsible government. At the same time, it had tended to make the Provinces the centres of the development of social services; and it had also tended to transfer to the Provincial Executives the prime responsibility for the preservation of law and order.'[2] It was these changes which led to the abolition of dyarchy and to the introduction of provincial autonomy in 1937.

[1] Speech of Lord Reading to the Joint Session of Indian Legislatures, July 28, 1923.

[2] *See* Joint Committee on Indian Constitutional Reforms, 1933-4, Vol. I, Part I, p. 9.

IV

THE MESTON SETTLEMENT AND ITS RESULTS

The division of public revenues among the different Provincial Governments covering a very wide geographical area was an extremely difficult problem in India. Under the highly centralized system of administration before the Reforms the division of financial responsibilities was comparatively simple. But with the introduction of responsible government the equitable distribution of burdens and resources was no longer an easy matter. The same forces which promoted the decentralization of governmental functions demanded the decentralization of the tax administration. The task of the Meston Committee was a very difficult one. For a proper understanding of the working of the Meston Settlement it is essential that we take into consideration the defects of dyarchy as well as the unforeseen economic circumstances under which the system was introduced. Hence we may divide the issues into three parts:

(i) The working of dyarchy and its financial effects.

(ii) The unforeseen economic circumstances and their effects on the working of the Meston Settlement.

(iii) An examination of the principles of the allocation of revenue and expenditure between the Central and Provincial Governments and between the Provinces *inter se*.

§ 1. *THE WORKING OF DYARCHY*

The Administration of Reserved and Transferred Subjects

The outstanding feature of government in the Provinces under dyarchy was the division of the administration into two distinct spheres—the 'transferred' and the 'reserved' halves of the Government. The theory of the dyarchic constitution was to make the ministers jointly responsible to the elected legislature in respect of the transferred half of the Government. But in the actual working of the constitution it became impossible to translate this theory into practice.[1] In their

[1] *See* Chs. III and V.

evidence before the Reforms Enquiry Committee the majority of the ex-ministers pointed out that they were dealt with by their Governors individually and not collectively. In other words, 'there were ministers but no ministries'. The growth of the principle of joint responsibility was largely dependent upon the personal equation of the ministers.[1]

The unhappy political circumstances under which the Reforms were started made it impossible for the ministers to secure an elected majority. The ministers were largely dependent on the support of the official bloc and were generally regarded as 'Government men'. Their policy was considerably influenced by the reserved side of the Government with the result that the ties between the ministers and their supporters weakened.

The failure to establish 'joint responsibility' on the transferred side further resulted in a loss of support and confidence of the provincial legislatures and ultimately impeded the conducting of business.

Again, the Act made no provision for joint deliberation between the two halves of the Government. The practice actually followed differed from province to province. In the United Provinces in the beginning 'there were weekly meetings of the whole Government'; such meetings generally became less frequent as time went on. In Madras, joint deliberation between the two halves of the Government was laid down as an essential feature and it exercised a wholesome influence in the working of the constitution.

The absence of joint deliberation gave rise at times to friction and feelings of mutual distrust between the ministers and the executive councillors, which were not conducive to efficient and good administration.

The success in the working of dyarchy was largely due to the dominant influence of the Governors in harmoniously combining the interests of the two halves of the Government.

[1] 'The evidence of Mr. Chitnavis and Rao Bahadur Kelkar of the Central Provinces, of Lala Harkishenlal of the Punjab, and of Sir P. C. Mitter of Bengal, shows that not only did the Governors deal with their ministers separately but the latter, in some provinces at any rate, themselves did not observe the convention of joint responsibility.' *Report of the Reforms Enquiry Committee: Minority Report*, p. 154. Cmd. 2360, 1925.

The precise extent to which dyarchy succeeded varies from province to province. Its success even in the same province differs from time to time with the personal equation of the Governors.

Joint or Separate Purse

Before the inauguration of the Reforms, the question of the Joint or Separate Purse loomed large in public discussions. There was much discussion as to whether the revenues of a province should be treated as one single fund out of which funds should be allocated to the two halves of the Government, or whether, in view of the dyarchic constitution, the transferred departments should have their own separate funds distinct from the resources available to the reserved departments. The authors of the Reforms proposed that the provincial budget should be framed by the executive Government as a whole. The first charge on provincial revenues was to be the provincial contribution to the Government of India; after that the supply for the reserved subjects was to have priority. Lastly, the allocation of supply for the transferred subjects was to be decided by the ministers, who were, with the Governor, also to decide the question of new taxation, if the revenues were insufficient.

These proposals were criticized by the Government of India on the ground that such a procedure for the allocation of revenues would create friction between the two halves of the Government. Nevertheless, they finally came to the conclusion that it was advisable to divide the revenues between the two halves of the administration and hence recommended the method of separate purses.

The Joint Select Committee, however, expressed its preference for a 'Joint Purse', and this arrangement was ultimately adopted in the Devolution Rules. Consequently, in each Governor's Province, under the Reforms, the budget was framed by the Finance Member, who belonged to the reserved half of the administration.

It is commonly supposed that this arrangement presented a serious difficulty in the working of the Reforms. This, however, was not the cause. The allocation of revenues between the

transferred and reserved subjects was decided by an agreement between the ministers and the Finance Member. Dr. Gangulee is hardly correct when he says that 'this proved to be a serious handicap to the ministerial position, and in every province this financial arrangement not only led to considerable friction but to a certain amount of irresponsibility in both the halves of the Government.'[1] The actual difficulty was the financial stringency which did not leave enough surplus funds for the ministers to develop 'nation-building' departments. The system of separate purses would probably have aggravated the difficulties instead of mitigating them.[2]

The Defects of Dyarchy

The defects in the working of dyarchy were brought into relief by the Reforms Enquiry Committee, generally referred to as the Muddiman Committee.[3] Most of the Provincial Governments and ministers who had worked the Constitution condemned the working of the system. 'It was a common cry', said the Bengal Government, 'that the transferred departments were being starved at the expense of the reserved departments. It was no wonder that when, under the reformed system, the popular ministers were unable through lack of money to produce and carry out schemes of development in education, public health and the like, the system has been condemned in many quarters.'[4]

Dyarchy, in the words of the Governor of the United Provinces, is obviously a cumbrous, complex, confused system, having no logical basis, rooted in compromise, and defensible only as a transitional expedient.[5]

[1] Gangulee, N., *The Making of Federal India*, Nisbet, 1936, p. 51.

[2] The Reforms Enquiry Committee (Majority and Minority) were both in favour of 'joint purses'. *See* Majority Report, pp. 92-3; Minority Report, p. 168: Cmd. 2360, 1925. The Simon Commission also favoured the 'joint purse'. *See* Cmd. 3568, 1930, par. 397.

[3] The Reforms Enquiry Committee, under the chairmanship of Sir Alexander Muddiman, was appointed by Mr. Ramsay MacDonald. The Committee issued two Reports—a Majority Report and a Minority Report. The report of the Committee is instructive as it contains the views of several ex-ministers who had actually worked the Constitution. Report, Cmd. 2360, 1925. The views of the Local Governments are given in Cmd. 2361 and 2362, 1925.

[4] Cmd. 2362, 1925, p. 140.

[5] Ibid. p. 168.

The Minister of Industries in Madras gave his experience of dyarchy in the following words:

> 'I am Minister of Development minus forests, and you all know that development depends a good deal on forests.[1] I am Minister of Industries without factories, which is a reserved subject, and industries without factories are unimaginable. I am a minister of agriculture minus irrigation. You can understand what that means. How agriculture can be carried on extensively without irrigation in the hands of those who are responsible for it is rather hard to realize. I am also Minister of Industries without electricity, which is also a reserved subject. The subjects of labour and boilers are also reserved.'[2]

From the foregoing account it is clear that the defects of dyarchy, caused partly by political difficulties, such as the lack of co-operation on the part of Swarajists, and partly by the absence of joint responsibility and joint deliberation, resulted in the creation of an atmosphere of mistrust and suspicion which dampened the enthusiasm and energies of the ministers.[3] This reacted on the financial policy, and the Meston Settlement was condemned in unequivocal terms everywhere.

§ 2. *THE EARLY FINANCIAL DIFFICULTIES IN THE WORKING OF THE MESTON SETTLEMENT*

Unforeseen Economic Circumstances

A common fallacy in the treatment of the problems of provincial finance in India is to regard the financial problems of the Central and Provincial Governments as entirely separate. Under the Reforms the system of central and provincial finance, though separated as book accounts, was largely interconnected and interdependent. The unsatisfactory position of the Government of India's finances,

[1] Forests were a 'reserved' subject except in Bombay, where they were 'transferred'.

[2] Cmd. 2362, 1925, p. 109.

[3] The Swarajists pledged themselves to a policy of uniform, continuous and consistent obstruction, with a view to making Government, through the Assembly and the Provincial Councils, impossible.

heavy losses on account of exchange difficulties, lowered railway earnings and the high expenses of the Frontier disturbances, largely aggravated the difficulties of the Provincial Governments in the successful working of the Reforms.

Heavy Central and Provincial Deficits

The Central Government was passing through a period of exceptional financial stress and strain. For five years in succession (1917-22) there was a deficit budget. The accumulated total deficit at the close of 1922-23 was no less than Rs. 100 crores, in spite of the additional heavy taxation. In two years, 1921-23, the Central Government impossed Rs. 23 crores of new taxation, apart from increased railway and postal charges. In 1923-24, the Government of India was again faced with a deficit of Rs. 4.5 crores which led to an increase of the salt duty to Rs. 2-8 per maund. Out of the total deficit of 100 crores, 31 crores was met by the creation of paper money, which represented nothing but the I.O.U's of the Government of India. The remaining 69 crores was raised through loans and the issue of Treasury Bills.[1]

The Provincial Governments were also passing through a period of financial distress. In March 1922, Lord Hailey put the excess of provincial expenditure over revenue at eight crores of rupees. The result was that most of the Provincial Governments were living on their balances, which were reduced from sixteen crores in 1921 to only five crores in 1922. Some of the provinces had exhausted their balances, while others were living on borrowed balances.[2]

The Difficulties in the Early Abolition of Provincial Contributions

The problem was an all-India one. The abolition or reduction of provincial contributions would have undoubtedly reduced the provincial deficits but the deficit of the Government of India would have increased. The total quantity of deficit would have been the same—whether we had wholly central

[1] *See* Sir Basil Blackett's speech introducing the Finance Bill for 1923-24, March 1, 1923.

[2] *See* Lord Hailey's speech introducing the Finance Bill for 1922-23, March 1, 1922.

or wholly provincial deficits or partly central and partly provincial deficits. The vacuum would have been either at Delhi or in the Provinces.

It was easy to suggest that provincial contributions should cease at once. But the crucial point is what were the alternative methods to restore the budgetary equilibrium of the Central Government? It would have been impossible to cut down the expenditure by say twenty to thirty crores per annum all of a sudden without any serious loss to administrative efficiency. The difficulties of increased taxation were immense. The best evidence of the difficulty of imposing new taxation is furnished by the Legislative Assembly refusing its assent to increase the salt duty in 1922 and twice again in 1923, even after the Finance Member had gravely assured the House that it was an emergency measure and the only way to financial solvency.[1] The Legislative Assembly still persisted in refusing its assent and the tax was thereupon certified by the Viceroy. Opinions will always differ as to how far Lord Reading was justified in certifying the Finance Bill in 1923. Perhaps the best criticism of the embarrassing situation is given by Dr. Anstey in the following sentences:

> 'It is difficult to decide how far the very violent opposition to the higher rate of duty was genuine, and how far the incident was utilized as a convenient stick with which to beat the Government at a period when non-co-operation was at its height. It is possible that the burden imposed by raising the tax has been exaggerated, but as the tax undoubtedly does not affect the whole population, it ought not to be increased except at a time of urgent financial stress.'[2]

[1] Sir Basil Blackett in his Budget speech, 1923, observed: 'I appeal to the House for one last long and strong pull, all of us pulling together, in the confident assurance that so doing we shall quickly get the boat out of the vicious current which is threatening to drag India down on to the rocks of insolvency. Once back in safe waters, I have every hope that in a surprisingly short time we shall find ourselves on the flood tide of prosperity, and shall be able to turn our minds to pleasant thoughts of reduced provincial contributions, reduced taxation, and increased devotion of our resources to the development of India....Let us crown our success by a fourth red-letter day, and end our Session with a balanced budget.' Sir Basil Blackett's speech introducing the Finance Bill, March 1, 1923.

[2] Anstey, V., op.cit., p. 380.

The Meston Settlement was based on the assumption that the deficit of the Central Government at the initiation of the Reforms, to be made good from provincial contributions, would be Rs. 9,83 lakhs. This figure was based upon various assumptions, three of which were of great importance. The first was the two-shilling rate of exchange; the second was a military budget of Rs. 43 crores; and the third was that the railways would yield a net profit of Rs. 8 to 10 crores per annum. These optimistic calculations were all falsified. The exchange rate behaved in a most wayward manner, resulting in a loss of no less than Rs. 15.5 crores; the military budget cost more than Rs. 20 crores beyond the assumed figure of Rs. 43 crores; the revenue from the railways was also disappointing; and the receipts depending on trade conditions fell off seriously. With this new situation it was obviously impossible for the Government of India to make a beginning in the reduction of provincial contributions. The increase of further debts would have been a dangerous and disastrous course.[1] To do so would have increased the uncovered deficit of the Central Government, which must inevitably have resulted in the financial insolvency and ultimate ruin of the whole country.

Conclusion

To conclude, the situation as explained above was certainly difficult—much more difficult than most people imagine or care to realize. The Meston Settlement received undue condemnation on account of the series of deficits in Central and Provincial budgets which coincided with the inauguration of the Reforms. With the steady revival in trade and increased prosperity, the era of unbalanced budgets disappeared. Sir Basil Blackett's six years of financial leadership saw the rehabilitation of the finances of the Central Government and marked the abolition of the much-talked of provincial contributions. The Government of India made a real and honest attempt to wipe

[1] 'A large volume of Treasury Bills is an evil in England, where the condition of the money market is such that it is always possible to renew maturing bills by offering a competitive rate, but in India conditions might easily arise under which even an impossible high rate would be insufficient, and in that case the Government of India would be driven back to replacing the Treasury Bills by paper currency, i.e. would be driven to taxation by inflation.'—Sir Basil Blackett's speech introducing the Finance Bill for 1923-24, March 1, 1923.

off the provincial contributions as soon as their financial position improved. Hasty measures in the field of finance always lead to disaster.

Provincial Contributions (1921-27)

The provincial contributions from 1921-22 to 1927-28 are shown in Table XV on the next page.

§ 3. *THE MESTON SETTLEMENT EXAMINED*

The Division of Functions between the Central and Provincial Governments

So far we have considered the defects of dyarchy and their reactions on the working of the financial arrangements. Incidentally, we have also mentioned the effects of the unforeseen economic circumstances which coincided with the early years of the working of the Reforms. Lastly, we have to discuss the question as to whether or not the Meston Settlement was fair and equitable.

The usual approach to the problem is to examine the adjustment of Governmental functions to revenues. The ideal distribution of these functions in relation to revenues among competing tax jurisdictions would be to harmonize the yield and elasticity of revenue with the growing needs of the Government. This, however, is rarely done. Hence the functions of overlapping tax jurisdictions always require transfers of funds from one jurisdiction to another.

The problem of financial relationships between the Central and Provincial Governments in India cannot be harmonized on account of constitutional and administrative difficulties. The Montford Reforms were a transitional stage in the constitutional evolution of the country. Under the Reforms scheme the Central Government was mainly responsible for defence, debt services and the commercial departments (the railways and the posts and telegraphs) of the Government of India. The Provinces were charged with the development of 'nation-building' services. Such a distribution of Governmental activities was entirely due to administrative convenience and political reasons.

TABLE XV

PROVINCIAL CONTRIBUTIONS TO THE CENTRAL GOVERNMENT[1]

(In thousands of rupees)

Provinces		1921-22	1922-23	1923-24	1924-25	1925-26	1926-27	1927-28
Madras.	..	3,48,00	3,48,00	3,48,00	3,48,00	2,21,98	1,65,19	
Bombay	..	56,00	56,00	56,00	56,00	34,00	28,00	
Bengal	.	63,00	(a)	(a)	(a)	(a)	(a)	
United Provinces	..	2,40,00	2,40,00	2,40,00	2,40,00	1,83,83	1,50,85	
Punjab	..	1,75,00	1,75,00	1,75,00	1,75,00	1,13,84	85,73	
Burma	..	64,00	64,00	64,00	64,00	44,35	50,23	
Bihar & Orissa		..	..	..	..	..	..	
Central Provinces	..	22,00	22,00	22,00	22,00	13,00	22,00	
Assam	..	15,00	15,00	15,00	15,00	9,00	15,00	
Coorg	..	..	..	..	12	12	12	
Total	..	9,83,00	9,20,00	9,20,00	9,20,12	6,20,33	5,17,12	

[1] Source: Cmd. 3610, 1930.
(a) Contribution remitted.
(b) The entire amount of the contributions was remitted in 1927-28.

The financial allocation of resources was a necessary corollary of the functions assigned to the Central and Provincial Governments. The functions of Government can be arranged in an ascending scale of urgency, ranging from those which concern the comfort and well-being of the individual to those which secure the existence of the State.[1] In every country the Central or Federal Government's basic obligation of maintaining the country's defence does not apparently affect or benefit the life of the average citizen; while the activities of the State or Provincial Governments deeply concern his daily life. The average citizen is more interested in the activities of the Provincial Governments which eradicate malaria, spread education, provide hospitals and dispensaries, and prevent thefts, than in the Central Government which keeps out the phantom foreign invader, controls the intricate policy of foreign exchanges, explores regions in the eternal snows of the Himalayas and builds capitals amidst the ruins of empires.[2] Thus the funds of the Provincial Governments require a flow of capital capable of vast expansions to carry out their ever-increasing activities on 'nation-building' departments. But under the new allocation of resources this was not the case. For the rapidly expanding needs of the provinces the sources of revenue assigned were inelastic and insufficient.

The Provincial Sources of Revenue were Inelastic

Land Revenue was the mainstay of provincial finance under the reformed constitution. In permanently settled parts of the country the yield from land revenue is not capable of any appreciable increase. The financial difficulties of Bengal and its claim for special treatment in the fixation and remission of provincial contributions were due to this highly inelastic source of revenue. In other provinces as well, on account of long-term settlements and the changed policy for reducing the burden of the cultivators followed in recent settlements, the increase in land revenue has not kept pace with its earlier

[1] Cmd. 9109, 1918, par. 188.

[2] Sir Basil Blackett did not favour the huge expenditure for the New Delhi scheme being met out of revenue. *See* his speech in introducing the Finance Bill, 1923-24.

yield. Though the net income from land revenue in 1925-26 was Rs. 6,41 lakhs greater than in 1901-2, its percentage in 1925-26 as compared with 1901-2 fell from 42 to 21 per cent of the total net revenue of the Central and Provincial Governments.[1]

The other provincial heads of revenue either required a large capital outlay for their development (e.g. forests) or on account of other reasons were not capable of much expansion. On the whole, the Provincial Governments had inelastic sources of revenue for their rapidly expanding needs.

The Central Sources of Revenue were Elastic

On the other hand the Central Government for its comparatively stationary needs had expanding sources of revenue. The yield of the three sources of revenue, namely customs, income-tax, and salt, can be seen from the following statement:

TABLE XVI

RECEIPTS FROM CUSTOMS, INCOME-TAX AND SALT[2]

Year	Customs	Income-tax	Salt
		(In thousands of rupees)	
1921-22 ..	34,37,42	22,17,54	5,97,52
1922-23 ..	41,29,24	18,13,94	6,42,36
1923-24 ..	39,64,40	18,49,12	9,63,97
1924-25 ..	45,69,27	16,21,23	7,02,67
1925-26 ..	47,68,09	16,12,04	5,92,69
1926-27 ..	47,28,31	15,98,28	6,31,63
1927-28 ..	48,11,54	15,42,63	6,22,15
1928-29 ..	49,11,89	17,05,64	7,20,43
1929-30 ..	51,12,59	17,06,34	6,36,76
1930-31 ..	46,64,27	16,30,97	6,44,09
1931-32 ..	46,25,49	17,56,95	8,35,52
1932-33 ..	51,67,47	18,00,31	9,83,29
1933-34 ..	46,85,58	17,15,89	8,51,24
1934-35 ..	52,36,50	17,58,04	7,63,67
1935-36 ..	53,77,59	17,09,95	8,06,11

[1] Anstey, op.cit., p. 368. *See* also the footnote on the same page for an excellent table showing a comparative view of change in the relative importance of certain outstanding sources of Indian revenue during 1883-84, 1923-24.

[2] Sources: Cmd. 3291, 1928; Cmd. 5804 1938.

Thus one of the chief defects of the Meston Settlement was that while it made the Provinces responsible for the development of the 'nation-building' activities, the sources of revenue which it placed at their disposal were inelastic. The unpopularity of the Reforms was largely due to the difficulties in finding additional sources of revenue.[1] Nor must it be forgotten that for this state of affairs the Provincial Governments were themselves responsible to some extent by not developing some of the sources of revenue suggested by the Taxation Enquiry Committee, e.g. succession duties. Doubtless in the early years of the Reforms, there was considerable difficulty in imposing increased taxation due to the persistent political opposition but the atmosphere had considerably improved in the later years of the working of the constitution. The failure to develop new sources of revenue resulted in creating gross inequalities of burdens between the different sections of the community.

Necessity for Provincial Contributions

The provincial contributions formed an important feature of the Meston Settlement. We must brush aside the common notions about provincial contributions which are widely held in India. The late Mr. Gokhale, one of the strongest advocates for a system of federal finance for India, in his evidence before the Decentralization Commission, outlined a scheme of federal finance in which the provinces were to contribute to the Central Government.[2] Professor Seligman also favoured

[1] The Muddiman Committee observed: 'It is due to it (i.e. the Meston Settlement) that ministers have been unable to enter upon a policy of progressive development in the spheres of administration committed to their care. If they had been able to do so, they would have been able to provide an answer to those critics who have reiterated the allegation that the Reforms were a sham, and they would also have been able to consolidate their position or else have been required to make way for other ministers who could have enunciated a policy more acceptable to the Councils which would incidentally have assisted in the establishment of the responsibility of the ministers to the Councils.' Report of Reforms Enquiry Committee, 1924. Majority Report, par. 56 Cmd. 2360, 1925.

[2] Mr. Gokhale in his evidence before the Decentralization Commission remarked: 'There should be no divided heads of either revenue or expenditure, but certain heads of revenue with the expenditure under them should be wholly imperial and the others wholly provincial. . . . on this basis of division, the revenues of all the Provincial Governments will be found to exceed their present scale of expenditure, while the reverse will be the case with the Government of India. To make up this deficit of the Supreme Government, the Provincial

the system of contributions from the Federal or Central to the State or Provincial Governments or vice versa.[1] A clear-cut division of functions and resources between various tax jurisdictions is only thinkable in a new island recently inhabited in which primitive conditions prevail. But even there after some time a mutual adjustment of functions and resources among the competing tax authorities would necessitate transfers of funds from one tax authority to another, as the financial history of several federations has proved.

Starting with the principle that the system of contributions is an acknowledged method of transferring funds from one tax jurisdiction to another, let us examine the various methods which the committee could have adopted for calculating the contributions. These can be arranged as follows:

(i) *Contributions in Proportion to Expenditure:* This recognizes thrift and penalizes extravagance. But as the expenses of Provincial Governments vary largely from province to province due to differences in the cost of administration and responsibility, such a method, taken by itself, would create inequalities of burdens. Bombay, for example, on account of its high cost of administration, would be penalized under the scheme. Moreover, it may lower the efficiency of administration by cutting down necessary expenditure in the race for false economy between various provinces. The relative positions of the various Provinces on the basis of a levy in proportion to expenditure based on the expenditure figures settled at the Simla Conference can be seen from Table XVII on the next page:

(ii) *Contributions Based on Population:* This provides a rough and ready method of assessing a levy, but it would not result in an equitable distribution of burdens. Population alone in a large country like India with its different parts unequally developed economically is a bad index for measuring the paying capacity of a province. Such a *levy*, would demand

Governments should make to it fixed annual contributions, which should be determined after a careful consideration of the average liability of each province to famine as also of the need of making increased grants to local bodies out of provincial resources.' Cmd. 4360, 1908, p. 58.

[1] Seligman, *Essays in Taxation*, 10th edition, pp. 663-69. *See* Ch. I for a discussion of the question.

from the thickly populated Province of Bihar and Orissa a far greater amount than from Bombay with its vast industrial concerns. The relative paying position of the nine provinces on the basis of population can be seen from Table XVIII:

TABLE XVII

Provinces	Normal Expenditure settled at the Simla Conference	Order in point of expenditure	Contributions fixed by the Committee	Order in point of the Contributions
	(Rs. lakhs)		(Rs. lakhs)	
Madras	10,55	2	3,48	1
Bombay	10,99	1	56	6
Bengal	7,92	4	63	5
United Provinces	8,63	3	2,40	2
Punjab	7,33	5	1,75	3
Burma	7,21	6	64	4
Bihar & Orissa	4,18	7	nil	..
Central Provinces	4,14	8	22	7
Assam	1,63	9	15	8

TABLE XVIII

Provinces	Population (in millions)	Order in point of population	Contributions fixed by the Committee	Order in point of the Contributions.
			(Rs. lakhs)	
Madras ..	42.3	3	3,48	1
Bombay ..	19.3	6	56	6
Bengal ..	46.7	1	63	5
United Provinces ..	45.4	2	2,40	2
Punjab ..	20.7	5	1,75	3
Burma ..	13.2	8	64	4
Bihar & Orissa ..	34.0	4	nil	..
Central Provinces ..	13.9	7	22	7
Assam ..	7.6	9	15	8

(iii) *Contributions Proportionate to Revenue:* This also is not a fair basis because the sources of revenue which are left to the

provinces bring different amounts of income. Land Revenue is a very important source of revenue to the Punjab and the United Provinces, while because of the Permanent Settlement it is a relatively small and highly inelastic source of revenue in Bengal and Bihar and Orissa. A levy proportionate to revenue would result in an increase in the taxation on those who are already the most heavily taxed. The comparative position of the Provinces on the basis of a levy proportionate to revenue based on the Simla Conference figures, as compared with the contributions fixed by the Committee, are shown in the following table:

TABLE XIX

Provinces	Normal Revenue settled at the Simla Conference	Order in point of revenue	Contributions fixed by the Committee	Order in point of the Contributions
	(Rs. lakhs)		(Rs. lakhs)	
Madras ..	14,42	1	3,48	1
Bombay ..	11,48	3	56	6
Bengal ..	7,73	6	63	5
United Provinces ..	12,07	2	2,40	2
Punjab ..	9,62	4	1,75	3
Burma ..	8,12	5	64	4
Bihar & Orissa ..	4,15	8	nil	..
Central Provinces	4,21	7	22	7
Assam ..	1,79	9	15	8

From the above table it is clear that if contributions based on revenue had been accepted, the position of Bombay would have been seriously affected. Bombay's position was sixth in the Meston Settlement while it would have occupied third place on the basis of a levy proportionate to revenue. The position of the United Provinces and Madras, on the other hand, would not have been affected.

(iv) *A Levy Proportionate to Surpluses:* This method was actually adopted by the authors of the Reforms. As noted in Chapter III, this method was most unfair, as it penalized thrift and encouraged extravagance. It took into consideration

the highest scale of expenditure and the lowest scale of revenue. The Meston Committee rightly abandoned it and adopted a new basis for its levy. The relative position of the various provinces on the basis of the Montford Reforms and the Meston Settlement are placed side by side in the following table:

TABLE XX

Provinces	Contributions proposed by the Authors of the Report	Order in point of Contributions proposed by the Report	Contributions fixed by the Meston Committee	Order in point of Contributions fixed by the Committee.
	(Rs. lakhs)		(Rs. lakhs)	
Madras ..	4,28	1	3,48	1
Bombay ..	88	5	56	6
Bengal ..	69	6	63	5
United Provinces ..	3,27	2	2,40	2
Punjab ..	2,18	3	1,75	3
Burma ..	1,40	4	64	4
Bihar & Orissa	39	7	nil	..
Central Provinces	36	8	22	7
Assam ..	13	9	15	8

The above table is instructive in pointing out that the relative position of Madras and the United Provinces in the scale of contributions was the same under both the Montagu-Chelmsford Reforms and the Meston Settlement. While Bombay was fifth under the Reforms scheme, it was sixth under the Meston Settlement.

(v) *Contributions on the Basis of the Increased Spending Power, under the new allocation of resources:* This system was adopted by the Meston Committee. But the Committee tempered this principle in the light of the actual economic circumstances of each province. Thus the underdeveloped province of Bihar and Orissa was entirely exempted from paying the initial contributions. Burma, Assam and the Central Provinces were also given special treatment. Bombay, Bengal, the United Provinces, the Punjab and Madras were treated equally.[1]

[1] *See* Ch. III.

The So-called Injustice of the Meston Settlement Examined

This new allocation of resources was universally condemned by all the Provinces.[1] The contributions fixed by the Committee were thought to be most unfair and inequitable. Each province had its own grievances and made the most of them. Bengal pointed out that her financial difficulties were peculiar and greater than those of the other Provinces on account of the Permanent Settlement. The Joint Select Committee had also recommended that Bengal should receive special consideration from the Government of India. Further, Bengal (and also Bombay) vehemently protested that under an equitable settlement the true test of what Bengal (or any other province) was paying to the Central Government was not its contribution under the Meston Settlement, but what the Central Government actually received from it in the shape of direct or indirect contributions. Bengal argued (and this applied equally to Bombay) that on account of her wealth, population, trade and industries, the monopoly of the jute trade and the port of Calcutta, her contribution to the Central Government in the shape of income-tax, super-tax and customs (apart from other items) far exceeded that of most other provinces.[2] Madras felt that she was the milch-cow and was proportionately contributing a larger share towards the Imperal deficit than any other province. The United Provinces and the Punjab complained that they were hard hit on account of the heavy contributions imposed on them and that the remaining revenues did not leave enough surplus for them to develop their potential industrial activities. Bombay lodged a protest that as she was an industrial province with a high cost of administration she had been most unfairly treated in the matter of income-tax, which she regarded as her best source of income. Bihar, even though contributing nothing, protested that as a backward province she required a large capital expenditure to bring her into line with the advanced industrial province of Bengal which had so far ignored her development and requirements. The Central Provinces made further claims

[1] For the views of the Provincial Governments on the Meston Committee Report, *see* Cmd. 974, 1920.
[2] *See* Ch. I.

upon the Central Government on account of their backward condition. Assam loudly protested that unless the arrangement was quickly changed her Government was 'predoomed to impotence and failure'. Lastly, Burma claimed larger revenues to develop her vast natural resources.[1]

In this sharp conflict of inter-provincial claims of interests, it was exceedingly difficult to achieve justice. Bearing in mind the past inequalities of treatment, and the differences of uneven economic development, let us examine the claims and counter-claims of the Provinces over the injustice of the Meston Settlement.

The fallacious arguments of Bengal and Bombay claiming special treatment were based on the so-called indirect contributions made by them to the central revenues. The Bengal Government, in its reply of June 2, 1920, to the proposals of the Financial Relations Committee, wrote: 'Under certain heads, e.g. railways and posts and telegraphs, this (i.e. the endeavour to ascertain indirect contributions), no doubt, would be difficult, if not impossible, but there are other sources, of which the important are income-tax (including super-tax) and customs (including salt), which bulk exceedingly largely in the figures and which have a vital bearing on the whole problem.'[2] Similarly the Bombay Government, in its reply of June 3, 1920 to the Government of India's letter, pointed out that the only solution for the success of the Reforms was to allow her a half share in the income-tax, including super-tax, collected in the Presidency.

These claims are based on the assumption that each province has a natural right to the revenues collected within its boundaries. This view is particularly indefensible in India where the tax jurisdictions were artificially made with the haphazard growth of British power in India. Let us take the most obvious examples, i.e. customs and income-tax. The customs revenue, collected in India at the important ports of Calcutta, Bombay and Madras, is a tax paid by the consumers of imported goods living in the remotest corners of the country and not only by the people in the provinces where the ports

[1] Cmd. 974, 1920.
[2] Ibid.

happen to be situated. In fact, it is impossible to find out the exact amount contributed by each province unless we develop the most elaborate system of bonding to trace the ultimate destination of the imported goods.

Similarly, in the case of income-tax (as we have already pointed out) the place where the tax is collected is not necessarily the place where the tax is earned. Large public companies do business in more than one State in India. Profits in the case of ramifying enterprises are collected at the headquarters of the business, but it is impossible to calculate what percentage of the profits are earned within the State where the business has its headquarters. However, in the case of public companies the shareholders are scattered all over India and the income-tax is collected at the head office of business. An allocation of income-tax receipts to the States on the basis of origin would result in vast inequalities of tax burdens.

But even if these difficulties could be overcome, it would be a travesty of justice to allocate such revenues to the States where the tax is collected, for, as the Simon Commission rightly observed, the population of towns, and in particular that of capital cities, builds up its economic life on that of the country as a whole, while the prosperity of the great ports has its root in the villages of the interior as well as in those of the seaboard states themselves. The profits of the shipping concerns, insurance companies, companies, commercial houses and the cotton or jute mills of Bombay and Calcutta depend on the prosperity of the country as a whole. It would be most unsound logic to attribute the revenues under these heads to Bengal or Bombay alone. On the contrary, the good fortune of the States is clearly dependent upon the general economic prosperity of the country as a whole, of which undoubtedly they are important parts.

Defects of the Meston System

The greatest defect of the Meston Settlement, however, lay in the fact that it created inequalities of tax burdens between the different classes of the community. It handicapped the industrial Provinces (as compared with the agricultural

Provinces) in not giving them power to tax industrial activities. Thus a highly industrialized province like Bombay was administered and financed out of the taxation of small cultivators (land revenue) and the labouring classes (excise). A detailed study of the provincial budgets elsewhere shows the huge divergence between the provinces in the extent of their dependence on various classes of revenue.[1] Bengal was largely financed out of the revenue from stamps arising mostly out of litigation. The prosperity of Madras, Bihar and Orissa depended largely upon the revenue derived from the sale of liquor licences. The poor cultivators of the United Provinces were made the scapegoats of the burdens and penalties of the costly administrative machinery. Thus the growth and development of education, hospitals and dispensaries, roads and industries, was financed in one province from the income from litigation, in another from the excessive consumption of the much hated liquor and in a third from the revenue derived from a highly indebted peasantry! A sad commentary on the distribution of burdens between the various sections of the community!

Again, it is significant to note that under the Meston Settlement, though the Provincial Governments provided law and order and improved the conditions of living in the provinces, an average citizen in urban areas who did not consume 'country' liquor or involve himself in litigation did not contribute anything towards the provincial finances. Hence the great majority of the people in cities were mainly contributing to the central finances (e.g. in customs, salt tax or income-tax) though they were mainly benefited by the activities of the Provincial Governments. The division of income-tax or excise duties is the only practicable way to remove such a defect.[2]

The relative importance of the principal sources of revenue to the total revenue of the province is shown in Table XXI on the next page.

Conclusion

In conclusion it may be noted that the Meston Settlement

[1] Cmd. 3569, 1930, par. 279.
[2] *See* Ch. I.

TABLE XXI

RELATIVE IMPORTANCE OF THE PRINCIPAL HEADS OF REVENUE TO THE TOTAL REVENUE OF THE PROVINCE

Provinces	Total Provincial revenue average 1925-35	Percentage of land revenue to the total revenue of the Provinces.	Order in point of percentage	Irrigation	Order	Excise	Order	Stamps	Order	Registration	Order	Forests	Order
	Rs. 1000												
Madras	16,81,57.8	34.9	5	10.2	2	29.3	1	13.7	4	2.1	2	3.1	6
Bombay	14,77,01.7	31.6	7	3.38	5	25.1	2	11.0	6	0.9	5	4.4	5
Bengal	10,32,74.9	28.3	8	-0.017	..	17.2	6	30.9	1	2.7	1	2.3	8
United Provinces	12,00,76.8	52.8	2	8.85	3	10.6	8	14.4	3	1.1	4	4.6	4
Burma	9,48,76.0	55.6	1	3.24	6	11.4	7	6.4	9	0.6	7	16.0	2
Central Provinces	4,89,32.9	46.1	3	0.15	7	20.1	5	12.6	5	1.2	3	17.5	1
Assam	2,50,75.3	45.8	4	..	..	22.6	3	8.1	8	0.8	6	9.9	3
Punjab	10,98,85.0	25.2	9	35.59	1	10.0	9	10.3	7	0.8	6	2.6	7
Bihar & Orissa	5,49,34.6	31.9	6	3.93	4	21.3	4	19.8	2	0.9	5	1.5	9

has not been studied in a scientific impartial spirit. Overzealous provincial patriotism has produced a distorted picture in which the real facts have been kept in the background. Those who condemn the Meston Settlement are out of court unless they can suggest a better alternative scheme within the constitutional machinery of the Reforms. It was not an ideal system and never claimed to be one. It was in harmony with the spirit of the Reforms. Change the character of the Reforms and the Meston Settlement is thrown overboard. The Meston Settlement has received more destructive than constructive criticism.

Above all, it must always be remembered that India as a whole is much bigger than any of the Provinces. The vital interests of the whole country are of greater importance than the isolated problems of any particular province. If the credit of India had been seriously shaken in the economic blizzard that swept the country between 1921-24, what would have become of the Provinces? Provincial autonomy would have ended in smoke. We must realize that we are citizens of India first and citizens of the Provinces or States next. Overzealous provincial patriotism is bound to breed jealousies which are highly detrimental to the progress of the country. The true line of patriotism lies in a frank and free recognition of the greatest needs of the country as a whole in subordination to the needs of the parts. The sooner this maxim is realized the sooner the different parts of the country will march towards the harmonious development of the whole country.

V

PROVINCIAL AUTONOMY

§ 1. *CONSTITUTIONAL BASIS*

Provincial Autonomy—a Natural Development

'The Provinces', wrote the authors of the Montagu-Chelmsford Reforms, 'are the domain, in which the earlier steps towards the progressive realization of responsible government should be taken. Some measure of responsibility should be given at once, and our aim is to give complete responsibility as soon as conditions permit'. The reforms of 1919 were a transitional stage in the introduction of provincial autonomy. The reforms had introduced a large measure of responsible government in the Provinces, but after working for more than a decade it was felt that a stage had been reached when the limits imposed by the Act of 1919 should be considerably extended. The lines of future reforms were examined by the Statutory Commission (1930). The principles of the constitutional settlement recommended by the Statutory Commission, however, were not favourably received in India. Meanwhile, Indian political opinion had become keenly conscious of the imperfections of the Indian polity so long as there was no constitutional relationship between the Indian States and British India. The three Indian Round Table Conferences and the Joint Committee on Indian Constitutional Reforms (1933-34) resulted in the passing of the Government of India Act, 1935. This Act established provincial autonomy in the Provinces (1937) and proposed to create an All-India Federation by means of which the Indian States and Provinces should decide policies affecting India as a whole.

Distribution of Legislative Powers

The Act of 1935 recognized three classes of subjects: (i) exclusively federal, (ii) exclusively provincial and

(iii) concurrent.[1] This means that functions, such as defence, foreign relations, the navy and air force, railways, currency and coinage, and public debt have been reserved for the federal authority. Secondly, education, medical, public health, police, law and order have been reserved for the Provincial Governments. Finally, there is a class of functions (e.g. employers' liability and workmen's compensation, trade unions and labour welfare) in which the Central Legislature has concurrent powers of legislation with the Provincial Legislatures, with provision for resolving a possible conflict of laws. In all federations it has been found necessary to provide the Central Legislature with the legislative jurisdiction throughout the country to secure uniformity in the main principles of law, and to permit the Provincial Legislatures to vary the laws to meet the particular circumstances of a province. The Concurrent legislative list provides for such cases.

As a result of this division of functions the Provinces possessed an exclusive authority to legislate on the provincial subjects. This authority was broadly free from the Central Government and the Central Legislature. In the Concurrent field of legislation the Provinces could vary the laws to suit local conditions.

Essence of Provincial Autonomy

The essence of provincial autonomy, as understood by the Joint Committee on Indian Constitutional Reforms (1933-34), consisted in each of the Governor's Provinces possessing an executive and a legislature having exclusive authority in a precisely defined sphere, within which it was broadly free from the control of the Central Government and Legislature. This represented a fundamental departure from the reforms of 1919, under which the Provincial Governments exercised a devolved and not an original authority. Under provincial autonomy the Central Government and Legislature ceased to possess in the Governor's Provinces any legal power or

[1] The subjects in List I, i.e. the exclusively provincial list, represent generally, with certain additions, those which the Devolution Rules under the Act of 1919 earmarked as 'Provincial Subjects'.

The dyarchic system in the Provinces by which the subjects were divided as 'Reserved' and 'Transferred' was abolished.

authority with respect to any matter falling within the exclusively provincial list of subjects, except that of supervision under certain conditions. The provincial executive, with the Governor as its head, was entirely responsible for provincial administration and the maintenance of law and order.

Main Features of Provincial Autonomy

There are thus three main features of provincial autonomy. In the first place it abolished the dyarchic system introduced by the Reforms of 1919. The division of provincial subjects into 'reserved' and 'transferred' was abolished, and the provincial ministers were generally responsible for the whole field of provincial government.

Secondly, the provincial executive was responsible for the fundamental functions of government: the enforcement of law and order and the maintenance of an upright administration. This responsibility raised a wider question, namely, the relationship of the provincial ministers with the Governor as the head of the provincial executive. Responsible parliamentary government, as rightly observed by the Joint Select Committee, works by the interaction of four essential factors: the principle of majority rule; the willingness of the minority for the time being to accept the decisions of the majority; the existence of great political parties divided by broad issues of policy, rather than by sectional interests; and the existence of a mobile body of public opinion, owing no permanent allegiance to any party and therefore able to keep the vessel on an even keel. In India some of these factors, as they are understood in the United Kingdom, did not exist. Hence it became essential to introduce some safeguards; that is, to give certain special responsibilities to the Governors. The safeguards, it was understood, were not to be used by the Governors in the daily administration of the Government. They were vested in them to hold the scales evenly between conflicting interests and to protect those who had neither the influence nor the ability to protect themselves.[1]

[1] The Governors were given the power to take executive action (*i*) to prevent any grave menace to the peace or tranquillity of the Province, or any part thereof; (*ii*) to safeguard the legitimate interests of minorities; (*iii*) to secure to the members of the Public Services any rights provided for them by the Cons-

Lastly, provincial autonomy meant greater responsibility in the sphere of social administration. The Government of India always followed a policy of neutrality and non-interference in all social and religious matters in India. This policy of non-interference, however justifiable it may have been in the past, needed a revision to carry into effect social legislation in such matters (to name only two obvious instances) as child-marriage and the problem of untouchables. Such reforms could only be carried out under a responsible government. Provincial autonomy offered the widest scope for that social legislation on which the future progress of India depended.

Provincial autonomy thus established a substantial measure of responsible government in the provinces. It is necessary, however, to realize that Indian constitutional problems are different from the constitutional problems of other countries. The responsible Government of India must be different from that of England, for responsible government is not an automatic device which can be manufactured to specification. Hence provincial autonomy in India was moulded to suit social conditions and national aptitudes. It is from this point of view that some necessary safeguards were inserted in the Instrument of Instructions. These safeguards did not lower the value of provincial autonomy but had strengthened the executive. Finally, it must be remembered that the success of a constitution depends far more upon the manner and spirit in which it is worked than upon its formal provisions.

§ 2. *THE CHANGES IN THE FINANCIAL SYSTEM*

Introduction

The problem of the allocation of resources between the Federation and the Units is necessarily a difficult one. The problem could be simplified if it were possible to allocate

titution and to safeguard their legitimate interests; (*iv*) to administer certain areas declared in accordance with special provisions, to be 'partially excluded' areas; (*v*) to secure the execution of orders lawfully issued by the Governor-General.

The Governor of Sind had the special responsibility for the administration of the Sukkur Barrage and Canals Scheme.

separate sources of revenue to the two authorities which would fit in with the economic and financial requirements of each party. This, however, is not an easy problem to solve. It has often been found that the yield from the sources of revenue assigned to the Units or the Centre is either deficient or in excess of their requirements, and hence a system of grants-in-aid or subventions is normally adopted to balance the budget.

In India the problem is not a new one. A system of doles from the Centre to the Provinces or contributions from the Provinces to the Centre, or a system of shared revenues, was often adopted by the two parties.[1] Together with this division of resources there was always a division of the functions to be performed by each party. Past experience has shown that the sources of revenue assigned to the Provinces were always inadequate for the full development of their social needs. Hence there had always been an attempt by the Provinces to demand a larger share of the resources of the Centre.

With the entry of the States into the Federation the question became one of formidable difficulty. The Butler Committee (1928-29) and the Davidson Committee (1932) attempted to solve the problem. The demand of the Provinces that the States should share the burden of the income-tax and the corporation tax, and the claim of the States that they should share in the proceeds of the Customs duties complicated the situation. The States' contributions to the Government of India and the rights of the maritime States in relation to sea customs presented problems of unusual difficulty.

In order to understand the allocation of the sources of revenue between the Centre and the Units it is essential to study the subject in two parts: first the allocation of the sources of revenue between the Federation and the Units;[2] and second, the financial position of the deficit provinces.

[1] *See* Chs. II, III and IV.

[2] For literature on the subject, see:

(1) *Report of Indian States Committee* (i.e. Butler Committee), 1928-29.

(2) *Report of the First Federal Finance Sub-Committee* (i.e. Peel Committee, October 9, 1931) Indian Round Table Conference, second session.

(3) *Report of the Federal Finance Committee,* i.e. Percy Committee, 1932, Cmd. 4069.

(4) *Report of the Federal Finance Committee* (Second Peel Committee, 1932-3), Cmd. 4238.

Allocation of Sources of Revenue between the Federation and the Federal Units

The Meston Scheme, from the practical financial point of view, by allocating separate fields of taxation to the Government of India and the Provinces aimed at introducing the federal system of finance. The working of the system led to three conclusions: (i) that the provinces rarely had incomes adequate for a full development of their social needs; (ii) that the division of the heads of revenue between the Centre and the Provinces left the Centre with elastic heads of revenue; (iii) that the system of reserving taxes on income for the Centre handicapped the more industrialized Provinces such as Bombay and Bengal.[1] An attempt was made in the Government of India Act, 1935, to remove these defects. Under this Act the sources of revenue due to the Federation and the Federal Units were allocated thus:

I. PROVINCIAL

(*A*) *Taxes Levied and Collected by Provinces*

1. Land Revenue.
2. Irrigation.
3. Duties of excise on the following goods manufactured or produced in the province and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India:
   (*a*) alcoholic liquors for human consumption;
   (*b*) opium, Indian hemp, and other narcotic drugs and narcotics, non-narcotic drugs;
   (*c*) medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (*b*) of this entry.
4. Taxes on agricultural income.

(5) *Report of the Indian States Enquiry Committee* (Financial) 1932 (Davidson Committee).
(6) *White Paper* (December, 1931).
(7) *Report of the Joint Committee on Indian Constitutional Reforms*, 1933-34.
(8) *The Government of India Act*, 1935.
(9) *Indian Financial Enquiry Report* (Sir Otto Niemeyer's Report, 1936, Cmd. 5181.)

[1] *See* Ch. IV.

5. Taxes on lands and buildings, hearths and windows.

6. Duties in respect of succession to agricultural land.

7. Taxes on mineral rights, subject to any limitations imposed by any Act of the Federal Legislature relating to mineral development.

8. Capitation taxes.

9. Taxes on professions, trades, callings and employments, subject, however, to the provisions of section 124A(1) of the Government of India Act.

10. Taxes on animals and boats.

11. Taxes on the sale of goods and on advertisements.

12. Cesses on the entry of goods into a local area for consumption, use or sale therein.

13. Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling.

14. Stamps and registration.

15. Dues on passengers and goods carried on inland waterways.

16. Tolls.

17. Fees in respect of any of the matters in the Provincial Legislative List, but not including fees taken in any court.

(*B*) *Taxes Levied and Collected by the Federation but Assigned to the Provinces*

1. Duties in respect of succession to property other than agricultural land.

2. The rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, proxies and receipts (as mentioned in Federal Legislative List I, item 57).

3. Terminal taxes on goods or passengers carried by railway or air.

4. Taxes on railway fares and freights.

(*C*) *Taxes Divided between the Federation and the Provinces and the Federal States*

1. Taxes on income other than agricultural income.

2. Salt duties.

3. Duties of excise on tobacco and other goods manufactured or produced in India except
   - (*a*) alcoholic liquors for human consumption;
   - (*b*) opium, Indian hemp and other narcotic drugs and narcotics, non-narcotic drugs;
   - (*c*) medicinal and toilet preparations containing alcohol, or any substance included in sub-paragraph (*b*) of this entry.
4. Export duties (with special provisions for the jute export duty, Section 140 (2), Government of India Act).

II. FEDERAL

(*A*) *Taxes Levied and Retained by the Federation*

1. Corporation tax.
2. Currency and coinage.
3. Federal railways.
4. Post and telegraph including telephones, wireless, broadcasting, and other like forms of communication.
5. Import and export duties (with exceptions mentioned above).
6. Military receipts.

(*B*) Besides, the Federal Authority may also retain in part or whole the revenues from any of the sources mentioned in (*C*) above.

Distribution of Income-tax and Corporation Tax

It will appear from the above allocation of resources between the Federation and the Units that the most important changes in the allocation in comparison with the Meston Scheme were with reference to (i) income-tax, (ii) corporation tax and (iii) excise and export duties.

The First Peel Committee (1931) recommended that income-tax should be Provincial and corporation tax Federal. Income-tax was, however, in the interest of efficiency and uniformity of rates, to be collected by the Federal Government, and the net proceeds were to be redistributed to the Provinces. The redistribution of the proceeds among the Provinces was a convenient way of alleviating the burden of some of the

provinces which are poorer than others. The actual process of distribution was left to the Percy Committee.[1]

The Percy Committee (1932), after a careful examination of the future finances of the Federal Government, came to the conclusion that the transfer of the entire income-tax to the Provinces would cause a huge permanent deficit in the Central finances. They therefore recommended that income-tax should be retained by the Federal Government, and a percentage of it should be transferred to each province. In addition, the Federal Government should also retain: (i) the tax paid by residents in the Federally Administered Areas and (ii) the tax paid on the salaries of federal officers. The corporation tax was to remain a federal source of revenue. The Committee recommended that the provincial contributions should be extinguished by annual stages over a definite period, such as ten or fifteen years.

As regards the principles of distribution of income-tax receipts, the Committee considered allocation on the basis of collection, population, origin and residence. Each of these methods was open to objection. Allocation on the basis of collection would have led to gross injustice as between province and province. Companies, operating over large areas, are assessed at their head office, which is often situated in a more industrially advanced province. Moreover, interest on securities held all over the country is paid at the Public Debt offices in Calcutta, Bombay and Madras. Thus the mere accident that the income is assessed at a certain place is no reason why the benefit should go to that particular province. This basis was, therefore, ruled out.

Distribution by population has no scientific basis because industrially-advanced rich provinces may have a small population. Yet population can be adopted with advantage for the distribution of taxes on certain forms of income which cannot easily be assigned to any particular locality, such as the undistributed profits of companies and the income of non-residents.

Allocation on the basis of origin is theoretically sound, but administratively it is not workable in respect of the income of

[1] Cmd. 4069, 1932.

individuals and even in respect of the income of companies it would be workable only if the allocation were to be made wholly on arbitrary lines 'either by investing income-tax officers with unlimited discretion, or by laying down uniform rules of allocation, irrespective of widely varying conditions'. Hence this method was also not adopted.

The Committee adopted residence (i.e. the tax actually paid by the residents of a province) as the basis of the allocation. Each province was credited with the tax paid by persons resident in it (i.e. by individuals, undivided Hindu families, unregistered firms and certain associations), including tax on dividends received by them from companies. In allocating ordinary income-tax on this basis, however, there were practical difficulties. As a substantial part of the ordinary income-tax is collected at the source and no formal assessment is made, on the assumption that the taxpayer has no other source of income, it was difficult to ascertain the amount of tax which should be credited to each province. The Committee recommended that the records should be modified in such a way as to facilitate the ascertainment of the personal income-tax which should be credited to each province. Meanwhile, they thought that the only practicable course was to throw all the personal income-tax (i.e. excluding personal super-tax) into a common pool and to distribute this pool between the Provinces on the estimated basis of the probable amount of tax paid by the residents on their incomes. As regards personal super-tax which is, generally speaking, collected after formal assessment, there could be no difficulty. It was to be credited to the Province where the assessment was made.

The proceeds from the assessment of the income of non-residents and undistributed profits of companies were to be distributed on the basis of population. This would have helped, to some extent, the poorer provinces with large populations, such as Bihar, Orissa and the United Provinces.

The Distribution Proposed

On the basis of the above recommendations the proceeds were to be distributed in the following manner:

		(lakhs of rupees)
Total Gross Yield of Income-tax		18,00
Less Cost of Collection		80
	Net Yield	17,20
Super-tax on Companies, Tax on Salaries of Federal Officers and Personal Income-tax and Super-tax levied in Federal Areas (to be Retained by the Federal Government)		3,70
Balance Available for Distribution to the Provinces ..		13,50

Out of the total, about Rs. 2,00 lakhs represented personal super-tax (i.e. other than company super-tax) and was to be distributed on the basis of actual collections from residents. Of the balance of Rs. 11,50 lakhs, about one-seventh was approximately estimated to be the tax on the undistributed profits of companies and on the incomes of non-resident persons. This amount (i.e. one-seventh of Rs. 11.50 lakhs) was to be distributed on the basis of population. The remaining six-sevenths was to be distributed on the basis of the estimated share of personal income-tax creditable to each province. The result of the distribution on the above basis is shown in Table xxii on the next page.

Although the above settlement of the Percy Committee was not adopted under the 1935 Act, yet it opened a new field of inquiry. The Committee must be given the credit for realizing the difficulties of the deficit provinces. Their analysis of the division of income-tax in various parts was of immense help in Sir Otto Niemeyer's settlement. Finally, the Committee came to the conclusion that perfect equality of treatment was an impossibility in any federation, let alone in India. The Committee's words may be quoted here with profit: 'It is doubtful whether a jealous comparison of relative burdens offers a sound basis for a successful partnership. Each partner in a new enterprise must bring something substantial into the common pool and may expect to derive solid advantages from the partnership commensurate with his contribution; but, if these conditions are fulfilled, the partners will be unwise to insist on a meticulous equality. They will probably find it best to take their associates as they are. Similarly, a new

Table XXII

DISTRIBUTION OF INCOME-TAX

(In lakhs of rupees)

Provinces	Two crores on Collections of Personal Super-tax	One-seventh of $11\frac{1}{2}$ crores on Population basis	Six-sevenths of $11\frac{1}{2}$ crores on basis of personal income-tax without Federal Salaries	Total
Madras	7	30	1,46	1,83
Bombay[1]	50	14	2,79	3,43
Bengal	1,10	32	2,63	4,05
United Provinces	8	31	84	1,23
Punjab	2	15	74	91
Bihar & Orissa	18	24	65	1,07
Central Provinces	3	10	46	59
Assam	1	6	22	29
North-West Frontier Provinces[2] ..	1	2	7	10
Total ..	2,00	1,64	9,86	13,50

[1] Includes Sind, figures for the latter in respect of Columns 2 and 4 are not readily available, but are roughly estimated at about one-sixteenth (under both the columns together) of the total figure for Bombay plus Sind.

[2] The share due to the North-West Frontier Province will presumably go in reduction of the subvention to that Province.

federation may find, at the commencement of its existence, that the conception of maintaining the status quo in non-essentials is a better guide to policy than any ambitious ideals of equality or uniformity.' (Par. 93)

The Report of the Second Peel Committee[1]

The Second Peel Committee (1932), following the lines of the Percy Report, envisaged a twofold division of taxes on income into shares which would be permanently assigned to the Federal Government and the Provinces. To the Federal Government was assigned the proceeds of the tax derived from: (i) corporation tax, (ii) tax on federal officers, (iii) tax in federal areas, (iv) tax on Government securities and (v) tax on the incomes of persons not resident in British India.[2] The whole of the remaining proceeds from taxes on income was to be assigned to the Provinces. The proposals in paragraphs 74 and 75 of the Percy Report (mentioned above) were regarded by the Committee as suitable for the actual distribution of the proceeds.

At the outset of the Federation, however, in order to ensure the solvency of the Central Government, it was proposed that out of the provincial share of taxes on income the Federal Government should retain a block amount for a period of x years. The amount would be deducted by the Federal Government from the total yield before any distribution took place.

The initial amount fixed for the period of x years, it was recommended, should gradually be reduced to zero. Hence the duration of the period was divided into two parts, during the second half of which the entire amount was to be finally allocated to the provinces. Regarding the duration of the x period the Committee were unable to report agreement on

[1] The Report is contained in Indian Round Table Conference (Third Session) November 17 to December 24, 1932, Cmd. 4238, 1933.

[2] The Committee thought, on the estimate of the Percy Report, that the yield from the five heads quoted above would be Rs. 5¼ crores out of the total yield of Rs. 17¼ crores.

The representatives of British India said that the Federal Government should retain only Rs. 5 crores, while the States' representatives agreed to assume the burden of corporation tax if the Federal Government retained Rs. 8½ crores (par. 4).

account of the differences between the British-Indian and the States' representatives—the former insisting on a minimum period of ten years divided into two parts of at least five years each, the latter insisting on limiting the x period to four or five years.

The States' representatives agreed to assume liability for the corporation tax on the expiration of the period of x years, subject to the understanding that, assessment of the tax on the companies in a state having been made, the State might raise the amount due to the Federation by any method it chose, and not necessarily by the actual levy of that tax.[1]

In addition to the above division of taxes on income it was recommended that, so far as British India was concerned, the Federal Government should have power to levy, for its own purposes, an additional tax on the heads of income-tax permanently assigned to the provinces. Similarly, each province individually was to have a right of surtax upon the personal tax levied on inhabitants under the heads permanently allocated to the provinces, subject to a maximum of 12 per cent of the tax centrally imposed. This surtax, like all other taxes on income, was to be collected by a federal agency.

White Paper Proposals[2]

The White Paper proposed the following solutions:

(i) Taxes on income derived from federal sources were to be permanently assigned to the Federation.

(ii) Of the yield of the rest of the normal taxes on income (except the corporation tax), not less than 50 and not more than 75 per cent was to be assigned (by Order in Council) to the provinces.

(iii) Out of the amount assigned to the provinces the Federal Government (during a transitional period) was to retain an amount which was to remain constant for three years and was thereafter to be reduced gradually to zero over a further period of seven years—the Governor-General being given power to suspend these reductions, if circumstances made it necessary to do so.

[1] Report, par. 8.
[2] December, 1931.

(iv) The Federal Government was to be empowered to impose a surcharge on taxes on income, the proceeds of which were to be devoted solely to federal purposes.

(v) The corporation tax was to be retained by the Federation, and after ten years, the tax should be extended to the States. The States, however, were given the right not to subject companies to the tax and to pay themselves to the Federation an equivalent lump-sum contribution.[1]

(vi) The Provincial Legislatures were empowered to impose a surcharge not exceeding 12½ per cent on the taxes levied on the personal income of persons resident in the province, and to retain the proceeds for their own purpose.[2]

(vii) The provinces were empowered to impose taxes on agricultural incomes, which are not at present subject to income-tax.

Joint Committee Report[3]

The Joint Committee suggested that the share assigned to the Provinces should not be more than 50 per cent. The determination of the actual period (3 and 7 years suggested by the White Paper) during which the Centre should retain a part of the portion assigned to the Provinces was left to be decided by an Order in Council.

The provincial surcharges of 12½ per cent on the taxes levied on the personal income of persons resident in the province were not favoured by the Committee.

Sir Otto Niemeyer's Report

Sir Otto Niemeyer was appointed to make recommendations after reviewing the budgetary positions of the Government of India and the Provinces, on matters under sections 138 (1) and (2) —the allocation of taxes on income other than taxes on agricultural income; 140 (2)— the assignment of the net proceeds of the jute export duty and 142—grants-in-aid to the revenues of the Provinces—of the Government of India Act, 1935.

[1] Par. 142.
[2] Par. 57.
[3] H.C. 5, part I, 1934.

Sir Otto's aim throughout his recommendations was two-fold. He always kept in mind the stability of the central finances. Besides, his aim was that at the inauguration of provincial autonomy each of the Provinces should be so equipped as to enjoy a reasonable prospect of maintaining financial equilibrium. A real attempt was made to remove the chronic state of deficit of some of the Provinces.

Regarding the distribution of income-tax[1] under section 138 of the Government of India Act, Sir Otto Niemeyer made the following recommendations:

(i) (*a*) That the percentage prescribed under Section 138 (1) should be 50 per cent.

(*b*) That the percentage distribution of this share to be prescribed under the same sub-section should be:

Madras	15
Bombay	20
Bengal	20
United Provinces	15
Punjab	8
Bihar	10
Central Provinces	5
Assam	2
North-West Frontier Provinces	1
Orissa	2
Sind	2

(ii) That the amount to be retained under section 138 (2) from this share should be:

For a first period of five years, in each year, the whole or such amount as, together with any general budget receipts from the railways, will bring the Central Government's share in the divisible total up to Rs. 13 crores, whichever is less; and

For a second period of five years, in the first year, five-sixths of the sum, if any, retained in the last year of

[1] Out of the total income-tax receipts the following deductions must be made to find out the amount available for distribution among the Provinces:
(*i*) Corporation tax.
(*ii*) Receipts from the Chief Commissioners' Provinces.
(*iii*) Receipts from Federal emoluments.
(*iv*) Cost of collection.
Of the residuum 50 per cent is allocated for Provincial distribution.

the first period, decreasing by a further sixth of that sum in each of the succeeding five years.

The most difficult question was the manner in which the proceeds of taxes on income were to be distributed among the Provinces. On this contentious question, on many occasions in the past, each Province had advocated the basis of division (collection, population, origin, residence) which would have given it the largest dividend. We have already remarked that no basis possesses any scientific validity or satisfies in any appreciable degree the test of the paying capacity of a Province. And, even if we could find out exactly to what part of India particular fractions of income belong and therefore where the incidence of the taxation burden rests, 'it is still arguable that in a federation other considerations are also involved; particularly if the benefits and incidence of other forms of common taxation are unequally divided as between the various partners.'[1]

After taking into consideration the various aspects of the problem, Sir Otto fixed the percentages mentioned above, partly on residence and partly on population, paying to neither factor a rigidly pedantic deference.[2] This, perhaps, has been the best proposal for the allocation of income-tax as between the Provinces *inter se*, since the Montagu-Chelmsford Reforms of 1919.

The Corporation tax is a federal source of revenue. It was not to be levied by the Federation in any federated state until ten years had elapsed after the establishment of the Federation. The Ruler of any Federal State was, however, authorized to pay the tax himself to the Federation. The tax in such a case was not be levied in the State. When the Ruler of a State so elected to pay the tax the officers of the Federation were not to call for any information or returns from any corporation in the State, but it was to be the duty of the Ruler to supply to the Auditor-General of India such information as he may reasonably require to enable him to determine the amount of any such contribution. If the Ruler of the State was dissatisfied with the determination as to the amount of the

[1] Par. 30.
[2] Par. 34.

contribution payable by his State in any financial year, he could appeal to the Federal Court, and if he established to the satisfaction of that Court that the amount determined was excessive, the Court was to reduce the amount accordingly and no appeal was to lie from the decision of the Court on the appeal.

Deficit Provinces

We now come to the question of deficit Provinces. Sir Otto after reviewing the budgetary position of the Provinces came to the conclusion that Sind, Orissa, Assam and the North-West Frontier Province could not balance their budgets and urgently needed additional resources.

Sind. In 1936-37 the Government of India provided a subvention to Sind of Rs. 102 lakhs plus non-recurrent grants of Rs. 4 lakhs for initial equipment and election costs and Rs. 2 lakhs unallocated. In addition Rs. 17½ lakhs were provided for buildings in Karachi.

The future finances of Sind were linked with the financial future of the Lloyd Barrage. After a survey of the prospects of the Barrage scheme, Sir Otto recommended that Sind should receive a subvention of 105 lakhs for a period of ten years (i.e. till 1946-47 inclusive); that then it should be diminished by Rs. 25 lakhs a year for twenty years; by Rs. 40 lakhs a year for the next five years; by Rs. 45 lakhs a year for the next succeeding five years and thereafter until the whole Barrage debt had been repaid the subvention should be at a rate of Rs. 50 lakhs a year. When the debt has been repaid (i.e. in about forty years from funding in 1942) any remaining portion of the subvention will, of course, in any event cease.[1] Besides this, a single non-recurrent grant of Rs. 5 lakhs, towards the cost of a jail at Shikarpur, was also recommended.

Orissa. In 1936-37 the Government of India assisted Orissa with a grant of Rs. 50 lakhs of which Rs. 40½ lakhs was in respect of the deficit in the budget; Rs. 7½ lakhs (non-recurrent) was given for the establishment of famine and road funds and initial equipment, and Rs. 2 lakhs was an unallocated grant.

Sir Otto recommended that the recurring grant for Orissa

[1] Par. 13.

should be fixed at Rs. 50 lakhs. In addition a non-recurring grant of Rs. 19 lakhs should be given.[1]

Assam. The recurring grant for Assam was fixed at Rs. 45 lakhs a year. In addition Rs. 7 lakhs per year was provided towards the cost of maintenance of the Assam Rifles. In view of this grant the claim of Assam for the proceeds of the excise duty on Assam oil did not require further consideration.

The North-West Frontier Province. The Province had received an annual subvention of Rs. 1 crore from the Government of India since 1932. This subvention under section 142 of the Government of India Act could be increased at any time without an address from the Federal Legislature.

The future subvention of the Province was fixed at Rs. 110 lakhs and it was recommended that the subsidy should be subject to revision after five years.

Subventions to Other Provinces. Apart from the specific cases of the deficit Provinces, some assistance was also recommended to other Provinces. This assistance was irrespective of the allocation of income-tax and was not affected by it. Below the whole provision is summarized:

	Rs.
Bengal	75 lakhs
Bihar	25 lakhs
Central Provinces	15 lakhs
Assam	45 lakhs (plus 7 lakhs in respect of the Assam Rifles, par. 15)
North-West Frontier Province	110 lakhs
Orissa	50 lakhs (plus 19 lakhs non-recurrent, and to diminish as indicated in par. 13 of the Report)
Sind	105 lakhs (plus 5 lakhs non-recurrent and to diminish as indicated in par. 13 of the Report)
United Provinces	25 lakhs for 5 years
Total	450 lakhs

Decentralization of Balances and Debt Cancellation

Sir Otto suggested that a part of the above subventions recommended to the Provinces, could be conveniently provided

[1] Par. 14.

by decentralization of balances and debt cancellation. On financial and administrative grounds the proposal was also extremely desirable. In so far as the Provinces would be using surplus balances, as a set-off to debts due by them to the Centre it was suggested that such reduction of their debts should be taken as part of the assistance proposed above. But because, as a result of this proposal, the Provinces had to bear certain interest charges which had hitherto fallen on the Centre, allowance was made for such charges before the actual assistance was counted.

In the case of Bengal, Bihar, Assam, the North-West Frontier Province, and Orissa, it was convenient to combine the results of the decentralization of balances and of debt cancellation. Accordingly in the case of these Provinces the entire existing debts were taken over by the Government of India. The resulting net annual budget saving to the Provinces was counted against the assistance proposed to them. In the case of the Central Provinces a part of the debt was cancelled.

The following table shows the debt cancellations and the approximate net annual saving to each Province:

		Lakhs of rupees
Bengal	All debt contracted with the Centre prior to April 1, 1936	33
Bihar		22
Assam		15½
North-West Frontier Province		12
Orissa		9½
Central Provinces	Deficit debt as on March 31, 1936 and approximately two crores of pre-Reform debt	15

Export Duty on Jute

Since 1921 Bengal had repeatedly pointed out the injustice of the Meston Award. In September, 1921, Lord (then Sir) Malcolm Hailey remitted Bengal's contribution of Rs. 63 lakhs to the Government of India. In the earlier discussions of the Round Table Conference the delegates from Bengal put forward a claim to a share of the proceeds from taxation on the export of jute. The Percy Committee (1932) did not favour the claim as it would raise highly controversial questions

of principle and would result in delaying *pro tanto* the remission of provincial contributions.

In Chapter I we have pointed out the desirability of utilizing excise and export duties as balancing factors to correct inter-provincial inequalities and to introduce an element of greater elasticity in provincial revenues. It was on this principle that the White Paper[1] recommended that the Federal Legislature be empowered to assign to the Provinces and the States, in accordance with such schemes of distribution as it might determine the whole or any part of the net revenue derived from some federal excises and export duties. However, in the case of export duties on jute or jute products, an assignment to the producing units was compulsory, and was to amount to at least 50 per cent of the net revenue derived from the duty.

Under the Government of India Act[2] not less than half of the net proceeds of the export duty on jute in each year was to be assigned to the Provinces or federated states in which jute was grown in proportion to the respective amount of jute grown therein. Sir Otto Niemeyer recommended that the percentage under section 140 (2) of the Act should be increased to 62½ on the estimated gross yield of the duty in 1936-37. This resulted in the following additions to the resources of the Provinces:

	Lakhs of rupees
Bengal	42
Bihar	2½
Assam	2¼
Orissa (*rather over*)	¼

Under the Government of India Act, the Federal Legislature was also empowered to assign to the Provinces the whole or any part of the net revenue derived from salt or other federal excises. This was a very important provision in the Act which could be utilized to fill the gaps and inequalities in the finances of the Provinces resulting from artificial provincial boundaries or other considerations.

The result of the help to the Provinces through subventions, assistance through debt cancellation, and the jute export duty is shown in the table on the next page.

[1] December, 1931.
[2] Section 140 (1).

Table XXIII

(In lakhs of rupees)

Provinces	Total subvention recommended	Assistance due to debt cancellation	Assistance due to jute export duty
Bengal	75	33	42
Bihar	25	22	2½
Central Provinces ..	15	15	..
Assam	45	15½	2¼
North-West Frontier Province	110	12	..
Orissa	50	9½	¼
Sind	105	..	..
United Provinces	25	..	..

After allowing for the advantage derived from the above sources, Sir Otto recommended that the annual grants-in-aid under section 142 of the Act charged on Central revenues should be as follows:

United Provinces	Rs. 25 lakhs (for a fixed period of five years)
Assam	Rs. 30 (in addition to the grants for the Assam Rifles)
North-West Frontier Province	Rs. 100 (Subject to reconsideration at the end of five years)
Orissa	Rs. 40 (increased to Rs. 47 lakhs in the first year and to Rs. 43 lakhs in the 2nd, 3rd, 4th and 5th years)
Sind	Rs. 105 (increased to Rs. 110 lakhs in the first year; subject to reductions set out in par. 13 of the Report)

Summary of Various Forms of Assistance

The various forms of assistance already given or recommended in the Report are:

(i) Cash subventions.
(ii) Fifty per cent of the jute duty.
(iii) Additional 12½ per cent of the jute duty.
(iv) Benefits from debt adjustment.
(v) Prospective shares from income-tax.
(vi) Relief through the creation of new provinces.

Table XXIV shows the assistance received by the Provinces by each of these methods.

TABLE XXIV

Financial assistance already given, proposed to be given or which will be effective immediately on introduction of new Constitution (in lakhs of rupees)

Provinces	Relief from separation & Orissa (par. 11)	Subvention proposed by Sir Otto Niemeyer (par. 24)	50 per cent share of duty on jute (based on figures in par. 28)	Extra $12\frac{1}{2}$ per cent of duty on jute proposed by Sir Otto Niemeyer (par. 22)	Benefit from consolidation and reduction or cancellation of debt (par. 21 & Appendix III)	Total
1	2	3	4	5	6	7
Madras	20	..	..	..	26.2	46.2
Bombay	90	..	..	..	14.5	104.5
Bengal	..	..	168	42	33	243
U.P.	..	25[1]	..	..	12.7	37.7
Punjab	8	..	..	..	1.7	1.7
Bihar	..	..	10	2.5	22	42.5
C.P.	..	..	..	..	20.9	20.9
Assam	..	30	9	2.25	15.5	56.75
N.W.F.P.	..	100[2]	..	..	12	112
Orissa	..	40[3]	1	0.25	9.5	50.75
Sind	..	105[4]	..	..	0.7	105.7
Total	118	300	188	47	168.7	821.7

1. For a period of five years. 2. Subject to reconsideration at the end of five years. 3. Additional Rs. 7 lakhs will be given in the first year, and Rs. 3 lakhs in the next four years. 4. For a period of ten years, to be reduced gradually thereafter (par. 13). In the first year an additional Rs. 5 lakhs to be given for the jail at Shikarpur.

Table XXIV (*Contd.*)

Share from income-tax which will accrue in full after ten years on assumption that the amount surrendered by Government will be Rs. 6 crores.		Total of columns 7 and 9 (in lakhs of rupees)	Percentage of total amount already surrendered by the Government of India
Percentage	Amounts (in lakhs)		
8	9	10	
15	90	136.2	9.6
20	120	224.5	15.7
20	120	363	25.6
15	90	127.7	9
8	48	49.7	3.5
10	60	102.5	7.2
5	30	50.9	3.6
2	12	58.75	4.8
1	6	118	8.3
2	12	62.75	4.4
2	12	117.7	8.3
100	600	1421.7	100

Review of the Report

It is unnecessary to repeat once more that no financial arrangements in India can satisfy with complete justice the claims and counter-claims of the different Provinces. It is, however, interesting to note the views of the Provincial Governments as set out in the Explanatory Memorandum on the Draft Orders.[1]

The Madras Government contended that its comparatively sound financial position was due to its policy of financial orthodoxy followed in balancing the budgets, through adequate taxation, in the economic depression. With reference to the distribution of income-tax it pointed out that Bombay with a population of 18 million is disproportionately benefited by the allocation of 20 per cent, as against Madras with a population of 44 million and an allocation of 15 per cent.[2]

The Bombay Government recorded an emphatic protest in regard to the recommendations of the Report as it took no steps to correct the position in which the Presidency had been placed by reason of the inequities and inherent unsoundness of the Meston Settlement, including the falsification of the forecast of revenue made by the Meston Committee, the complete failure of the anticipations of the Percy Committee, and the cost of development schemes in Bombay City undertaken at the behest of the Secretary of State.[3]

The Bengal Government was not satisfied with the allocation of 62½ per cent of the proceeds of the jute export duty and reiterated its claim that the entire proceeds of the duty should be credited to the Provincial Government. It asserted that Bengal can never rest content under a fiscal system which aims at protecting, largely at her expense as a consumer, the products of other Provinces, while taxing her staple product for the benefits of the Centre, in other words for the benefit of other Provinces.

The United Provinces Government accepted the general conclusions of Sir Otto Niemeyer but pointed out the peculiar position of the Province on account of agrarian difficulties.

[1] Cmd. 5181, 1936.
[2] Letter dated May 5, 1936.
[3] Letter dated May, 1936.

For the last five years the Province had been giving an annual remission of Rs. 112 lakhs of land revenue which carried with it a remission of annual rent to tenants amounting to Rs. 4 crores. The Government suggested that the subvention should be raised to Rs. 40 lakhs (in place of Rs. 25 lakhs) for each of the first three years and be fixed at Rs. 25 lakhs, as proposed in the Report, for the remaining two years.[1]

The Punjab Government made out a very strong case. It contended that the comparative stability of its revenues during the past three years was attributable to four main causes: (i) a high standard of taxation, (ii) drastic retrenchment, (iii) the strictest control over new expenditure, and (iv) favourable harvests.[2]

Table XXIV points out the injustice done to the Punjab. It is seen from the table that in the immediate relief amounting to Rs. 8,22 lakhs, the Punjab got Rs. 1.7 lakhs or one-fifth of 1 per cent. Out of the total relief which was estimated at Rs. 14.22 lakhs at the end of ten years, the Punjab would have received Rs. 49.7 lakhs or 3.5 per cent.

[1] Letter dated May 6, 1936.
[2] Ibid.

VI

FEDERAL FINANCE UNDER THE CONSTITUTION

§ 1. *CONSTITUTIONAL BASIS*

In the preceding chapters we have described the development and working of the Indian financial system till the passing of the Constitution of India. With the independence of the country the political status of India underwent a fundamental change and the Constitution of India, passed on the 26th November, 1949, turned the country into a Sovereign Democratic Republic. The preamble to the Constitution secures to all the citizens of India:

JUSTICE, social, economic and political;

LIBERTY of thought, expression, belief, faith and worship;

EQUALITY of status and of opportunity; and to promote among them all;

FRATERNITY assuring the dignity of the individual and the unity of the Nation.

It is not possible here to enter into any detailed discussion of the main features of the Constitution. However, a passing reference to some of the salient features is necessary in order to point out the effects of the Constitution on Indian federal finance. These changes may be described under two main heads, viz.:

(1) Fundamental Rights and Directive Principles of State Policy; and

(2) Distribution of Legislative Powers between the Union and the States.

Fundamental Rights

Indian federal finance in future would be profoundly influenced by the Fundamental Rights and Directive Principles of State Policy as provided for in the Constitution. Some of the important Fundamental Rights which would influence the

financial policy of the Government of India and State Governments are as follows:

(1) All citizens shall have the right to acquire, hold and dispose of property.

(2) Traffic in human beings and beggars and other forms of forced labour are prohibited.

(3) No child below the age of fourteen years shall be employed to work in any factory or mine or engaged in any other hazardous employment.

(4) No person shall be compelled to pay any taxes, the proceeds of which are specifically appropriated in payment of expenses for the promotion or maintenance of any particular religion or religious denomination.

(5) No person shall be deprived of his property save by authority of law.

(6) No property, movable or immovable, including any interest in, or in any company owning, any commercial or industrial undertaking, shall be taken possession of or acquired for public purposes under any law authorising the taking of such possession or such acquisition, unless the law provides for compensation for the property taken possession of or acquired and either fixes the amount of the compensation, or specifies the principles on which, and the manner in which, the compensation is to be determined and given.

(7) If any Bill pending at the commencement of the Constitution in the Legislature of a State has, after it has been passed by such Legislature, been reserved for the consideration of the President and has received his assent, then, notwithstanding anything in the Constitution, the law so assented to shall not be called in question in any court on the ground that it contravenes the provisions of Article 31 Clause(2).

(8) Any law of the State enacted not more than eighteen months before the commencement of the Constitution may within three months from such commencement of the Constitution be submitted to the President for his certification; and thereupon, if the President by public notification so certifies, it shall not be called in question in any court on the ground that it contravenes the provisions of Article 31

Clause(2) or has contravened the provisions of sub-section (2) of section 299 of the Government of India Act, 1935.

Directive Principles of State Policy

The Directive Principles of State policy are not enforceable by any court but the principles embodied in them are nevertheless of fundamental importance in the governing of the country and it shall be the duty of the State to apply these principles in making laws. The Constitution envisages that the State shall strive to promote the welfare of the people by securing and protecting as effectively as it may a social order in which justice, social, economic and political, shall inform all the institutions of the national life. The following are some of the important Directive Principles of State Policy:

(1) The State shall direct its policy towards securing:

(*a*) that the citizens, men and women equally, have the right to an adequate means of livelihood;

(*b*) that the ownership and control of the material resources of the community are so distributed as best to subserve the common good;

(*c*) that the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment;

(*d*) that there is equal pay for equal work for both men and women;

(*e*) that the health and strength of workers, men and women, and the tender age of children are not abused and that citizens are not forced by economic necessity to enter avocations unsuited to their age or strength;

(*f*) that childhood and youth are protected against exploitation and against moral and material abandonment.

(2) The State shall take steps to organise village Panchayats and endow them with such powers and authority as may be necessary to enable them to function as units of self-government.

(3) The State shall, within the limits of its economic capacity and development, make effective provision for

securing the right to work, to education and to public assistance in cases of unemployment, old age, sickness and disablement, and in other cases of undeserved want.

(4) The State shall make provision for securing just and humane conditions of work and for maternity relief.

(5) The State shall endeavour to secure, by suitable legislation or economic organisation or in any other way, to all workers, agricultural, industrial or otherwise, work, a living wage, conditions of work ensuring a decent standard of life and full enjoyment of leisure and social and cultural opportunities and, in particular, the State shall endeavour to promote cottage industries on an individual or co-operative basis in rural areas.

(6) The State shall endeavour to provide, within a period of ten years from the commencement of the Constitution, for free and compulsory education for all children until they complete the age of fourteen years.

(7) The State shall promote with special care the educational and economic interests of the weaker sections of the people, and, in particular, of the Scheduled Castes and the Scheduled Tribes, and shall protect them from social injustice and all forms of exploitation.

(8) The State shall regard the raising of the level of nutrition and the standard of living of its people and the improvement of public health as among its primary duties and, in particular, the State shall endeavour to bring about prohibition of the consumption except for medicinal purposes of intoxicating drinks and of drugs which are injurious to health.

(9) The State shall endeavour to organise agriculture and animal husbandry on modern and scientific lines and shall, in particular, take steps for preserving and improving the breeds, and prohibiting the slaughter of cows and calves and other milch and draught cattle.

Distribution of Legislative Functions

In Chapter I we have described the principles underlying the distribution of functions between a federation and its units. The distribution of legislative powers between the Union and

the States is, more or less, on the lines of the Government of India Act, 1935. Under the Constitution there is a threefold distribution of legislative powers between the Union and the States, viz. the Union List, the Concurrent List and the State List (Art. 246). Matters in which the Parliament has exclusive power to make laws are enumerated in List I in the Seventh Schedule to the Constitution (i.e. the Union List). The Parliament and the Legislature of any State specified in the First Schedule, subject to certain restrictions, have the power to make laws with respect to any of the matters enumerated in List III (i.e. the Concurrent List). Finally, the Legislature of any State has the exclusive power to make laws for any of the matters enumerated in List II (i.e. the State List). Thus the defence of India; the naval, military and air forces; foreign affairs; the railways; shipping; the public debt of the Union; the Reserve Bank of India; the post office; trade and commerce; banking; insurance; taxes on incomes other than agricultural income; customs duties, including export duties; excise duties on tobacco and other goods manufactured or produced in India (except alcoholic liquors for human consumption); corporation tax; taxes on the capital value of the assets, exclusive of agricultural land, of individuals and companies; estate duty in respect of property other than agricultural land; terminal taxes on goods or passengers carried by the railway, sea or air; taxes on railway fares and freights; taxes, other than stamp duties, on transactions in stock exchanges and future markets; rates of stamp duty in respect of bills of exchange, cheques, and promissory notes; taxes on the sale or purchase of newspapers and on advertisements published therein; are some of the important items enumerated in the Union List.[1]

It is important to mention that the residuary powers of legislation vest in the Parliament. Thus Parliament has the exclusive power to make any law with respect to any matter not enumerated in the Concurrent List or the State List. Such power includes the power of making laws imposing a tax not mentioned in either of the above Lists.

[1] For a complete list of the legislative powers of the Union and the States, *see* Appendix II.

The Legislature of any State has the power to make laws regarding public order; the police; local self-government; public health; sanitation; hospitals and dispensaries; production; the manufacture and sale of intoxicating liquors; education; agriculture; forests; betting and gambling; land revenue; taxes on agricultural income; duties in respect of succession to agricultural land; estate duty in respect of agricultural land; taxes on lands and buildings; taxes on mineral rights subject to any limitations imposed by Parliament by law relating to mineral development; excise duties on alcoholic liquors for human consumption; opium, Indian hemp and other narcotic drugs and narcotics; taxes on the entry of goods into a local area for consumption, use or sale; taxes on the consumption or sale of electricity; taxes on goods and passengers carried by road or on inland waterways; taxes on vehicles; taxes on animals and boats; tolls; taxes on professions, trades, callings and employments; capitation taxes; taxes on luxuries, including taxes on entertainments, amusements, betting and gambling; and rates of stamp duty in respect of documents other than those specified in the provisions of List I with regard to rates of stamp duty.

Finally, the important matters stated in the Concurrent List are economic and social planning; commercial and industrial monopolies, combines and trusts, and trade unions; industrial and labour disputes; the welfare of labour, including conditions of work, provident fund, employer's liability, workmen's compensation, invalidity and old age pensions, and maternity benefits; price control; factories; boilers; electricity; newspapers, books and printing presses; stamp duties, duties other than duties or fees collected by means of judicial stamps, but not including rates of stamp duty.

The need for a Concurrent List of subjects, over which the Union and the States have Concurrent powers of legislation, is uniformity in legislation. The Joint Parliamentary Committee on Indian Constitutional Reforms (1934) observed that experience has shown, both in India and elsewhere, that there are certain matters which cannot be allocated exclusively either to a Central or to a Provincial Legislature, and for which, though it is often desirable that Provincial legislation

should make provision, it is equally necessary that the Central Legislature should also have a legislative jurisdiction, to enable it in some cases to secure uniformity in the main principles of law throughout the country; in others to guide and encourage provincial efforts; and in others again to provide remedies for mischief arising in the provincial sphere but extending or liable to extend beyond the boundaries of a single province.

Instances of the first are provided by the subject matter of the great Indian Codes; of the second by such matters as labour legislation; and of the third by legislation for the prevention and control of epidemic disease.

It would be disastrous if the uniformity of law which the Indian Codes provide were destroyed or whittled away by the un-co-ordinated action of Provincial Legislatures. On the other hand, local conditions necessarily vary from province to province, and Provincial Legislatures ought to have the power of adapting general legislation of this kind to meet the particular circumstances of a province.[1]

Conclusions

Such, in brief, are the broad characteristics of the Constitution in the field of the distribution of legislative powers between the Union and the States. The rationale of the division of the taxing powers follows closely the above division of the legislative functions. Broadly speaking, it may be said that the Indian Constitution is a highly centralized federal Constitution and in the sphere of taxing powers that type of simple dichotomy reserving indirect taxes to the Federation and direct taxes to the State is not found in the Constitution. The rival claims of centralization and decentralization in federal finance which would baffle even the most ingenious administrator have been solved in a most satisfactory manner. This is perhaps the most important feature of the Constitution. We shall come to this in Section II of this chapter.

Above all, the nature and composition of the Indian tax structure would be profoundly influenced by the Fundamental

[1] See the *Report on Joint Parliamentary Committee on Indian Constitutional Reforms*, 1934, par. 51.

Rights and Directive Principles of State Policy. Similarly, public expenditure would be guided by two main objectives, viz. (1) to provide a better standard of life for the people; and (2) social justice. Economic equality is the ideal to be achieved under the Constitution. At present there are large inequalities in the distribution of wealth between the rich and the poor, between the urban and rural areas. The Constitution has suggested fiscal and legislative measures to bring about economic equality. Since taxation alone could not achieve this objective the Constitution lays emphasis on the need for a change in the economic pattern of the country. Democracy in India can only survive through a radical change in land policy. The abolition of the zamindari system is the first step towards the creation of a Welfare State in India. The other method is to divert public expenditure to raise the standard of life of the common man through an improvement in the economic and social status of the more vulnerable classes and through an increase in the wealth and production capacity of the community as a whole. The protection of tenants, labour welfare, the amelioration of the backward classes and the substitution of usury by organized credit are steps to this end. Agricultural development and the promotion of cottage industries on an individual or co-operative basis, through State help, will go a long way towards rectifying the prevailing inequalities.

It should be borne in mind, however, that there are real dangers in bringing about too rapid a change in the economic pattern of the country. Firstly, Indian economy is not fully integrated. Secondly, a large section of our economy responds slowly to economic stimuli. But a static social ideal cannot co-exist with a progressive economic ideal. Finally, the federal structure of the Constitution in which the States are largely autonomous in providing social services, involves problems of effective co-ordination of policies and programmes between the Union and the States. The States would in future play the most important role in changing the economic and social pattern of the country. Thus a carefully planned, integrated financial system of the country as a whole is the most important need of the day.

§ 2. *DISTRIBUTION OF REVENUES BETWEEN THE UNION AND THE STATES*

The Constitution has, to a large extent, followed the allocation of revenues between the Federation and the States on the lines of the Government of India Act, 1935. With the entry of the former Indian States into the Federation the question of the both allocation of revenues and the distribution of grants-in-aid has become one of formidable difficulty. In order to understand the present allocation of revenues between the Federation and the States, it is essential to study the subject in two parts; first, the allocation of revenue between the Federation and the States; and second, the distribution of grants-in-aid. Under the Constitution the sources of revenue due to the Federation and the States have been allocated thus:

A. *State Sources of Revenue*[1]

The following taxes are levied and collected by the States:

(1) Land Revenue, including the assessment and collection of revenue.

(2) Taxes on agricultural income.

(3) Duties in respect of succession to agricultural land.

(4) Estate duty in respect of agricultural land.

(5) Taxes on land and buildings.

(6) Taxes on mineral rights, subject to any limitation imposed by Parliament by law relating to mineral development.

(7) Duties of excise on the following goods manufactured or produced in the State and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India:

(*a*) alcoholic liquors for human consumption;

(*b*) opium, Indian hemp and other narcotic drugs and narcotics;

but not including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (*b*) of this entry.

[1] *See* Appendix II.

(8) Taxes on the entry of goods into a local area for consumption, use or sale therein.

(9) Taxes on the consumption, or sale of electricity.

(10) Taxes on the sale or purchase of goods other than newspapers subject to the provisions of entry 92A of List I.

(11) Taxes on advertisements other than advertisements published in the newspapers.

(12) Taxes on goods and passengers carried by road or inland waterways.

(13) Taxes on vehicles, whether mechanically propelled or not suitable for use on roads, including tramcars (subject to the provisions of entry 35 of List, i.e. Concurrent List)

(14) Taxes on animals and boats.

(15) Tolls.

(16) Taxes on professions, trades, callings and employments.

(17) Capitation taxes.

(18) Taxes on luxuries, including taxes on entertainments amusements, betting and gambling.

(19) Rates of stamp duty in respect of documents other than those specified in the provisions of List I (i.e. Union List) with regard to the stamp duty.

(20) Fees in respect of any of the matters in List II, but not including fees taken in any court.

B. *Taxes Levied and Collected by the Union but Assigned to the States*

The following duties and taxes shall be levied and collected by the Government of India but the net proceeds in any financial year of any such duty or tax shall be distributed among those States in accordance with such principles of distribution as may be formulated by Parliament by law:

(*a*) duties in respect of succession to property other than agricultural land;

(*b*) estate duty in respect of property other than agricultural land;

(*c*) terminal taxes on goods or passengers carried by railway, sea or air;

(*d*) taxes on railway fares and freights;

(*e*) taxes other than stamp duties on transactions in stock exchanges and future markets;

(*f*) taxes on the sale or purchase of newspapers and on advertisements published therein.

(*g*) taxes on the sale or purchase of goods other than newspapers, when such sale or purchase takes place in the course of inter-State trade or commerce.

C. *Duties Levied by the Union but Collected and Appropriated by the States*

Under the Constitution such stamp duties and duties of excise on medicinal and toilet preparations as are mentioned in the Union List shall be levied by the Government of India but shall be collected:

(*a*) in the case where such duties are leviable within any Union territory, by the Government of India, and

(*b*) in other cases, by the States within which such duties are respectively leviable.

The proceeds in any financial year of any such duty leviable within any State shall not form part of the Consolidated Fund of India, but shall be assigned to that State.

D. *Taxes Levied and Collected by the Union and Distributed between the Union and the States*

(1) Taxes on income other than agricultural income.

(2) Union duties of excise other than such duties of excise on medicinal and toilet preparations as are mentioned in the Union List shall be levied and collected by the Government of India.

Union Taxation

The principal items of revenue stated in the Union List are as follows:

(1) Railways.

(2) Posts and telegraphs, telephones, wireless, broadcasting and other like forms of communication.

(3) Property of the Union and the revenue therefrom, but as regards property situated in a State subject to

legislation by the State, save in so far as Parliament by law otherwise provides.

(4) Public debt of the Union.

(5) Currency, coinage and legal tender; foreign exchange.

(6) Foreign loans.

(7) Reserve Bank of India.

(8) Post Office Savings Bank.

(9) Lotteries organised by the Government of India or the Government of a State.

(10) Taxes on income other than agricultural income shall be levied and levied and collected by the Government of India and distributed between the Union and States in the manner prescribed by the President by orders after considering the recommendation of the Finance Commission.[1]

(11) Duties of customs including export duties.

(12) Duties of excise on tobacco and other goods manufactured or produced in India except

(*a*) alcoholic liquors for human consumption;

(*b*) opium, Indian hemp and other narcotic drugs and narcotics;

but including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (*b*) of this entry.

(13) Corporation tax.

(14) Taxes on the capital value of the assets, exclusive of agricultural land, of individuals and companies; taxes on the capital of companies.

(15) Estate duty in respect of property other than agricultural land.

(16) Terminal taxes on goods or passengers, carried by railway, sea or air; taxes on railway fares and freights.

(17) Taxes other than stamp duties on transactions in stock exchanges and future markets.

(18) Rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit,

[1] Taxes on income do not include:

(*a*) a corporation tax;

(*b*) 'Union emoluments' which include all emoluments and pensions payable in respect of Union territories (i.e. Part C of the First Schedule).

policies of insurance, transfer of shares, debentures, proxies and receipts.

(19) Taxes on the sale or purchase of newspapers and on advertisements published therein.

(20) Taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce.

(21) Fees in respect of any of the matters in the Union List, but not including fees taken in any court.

§ 3. *DISTRIBUTION OF INCOME-TAX AND JUTE EXPORT DUTY*

Distribution of Income-tax

It will appear from the above allocation of resources between the Union and the States, that the most important changes in the allocation, as compared with the Government of India Act, 1935, have been made regarding the income-tax, the jute export duty, and the excise duties.

The Government of India Act, 1935, laid down fixed percentages for the distribution of income-tax between the Centre and the Provinces. The actual allocation, however, was left to Sir Otto Niemeyer. Sir Otto fixed the Provincial share at 50 per cent which was distributed among the Provinces. Under the Constitution the percentage of the net proceeds of the income-tax in any financial year (except the proceeds which represent proceeds attributable to Union territories or taxes payable, in respect of the Union emoluments) shall be distributed among the States in a manner as may be prescribed by Parliament. For this purpose, a Finance Commission shall be constituted by the President and the net proceeds available for distribution shall be prescribed by the President by Order, after considering the Commission's recommendation. Until a Finance Commission is appointed the percentage and the manner of distribution among the States of the net proceeds of income-tax shall be prescribed by the President by Order. However, the States possess no constitutional right of a fixed percentage of income-tax.

Distribution of Export Duty on Jute

Under the Government of India Act, 1935, not less than half of the net proceeds of the export duty on jute in each year was to be assigned to the Provinces in which jute was grown in proportion to the respective amount of jute grown therein. The Act, however, left Sir Otto Niemeyer to fix the exact percentage and its distribution among the Provinces. Sir Otto had recommended that the percentage under section 140(2) of the Government of India Act, 1935, should be increased to 62½ on the estimated gross yield of the duty in 1936-37. Under the Constitution the export duty on jute and jute export products shall not be divided between the Union and the jute-growing States, but in lieu of the jute export duty, grants-in-aid out of the Consolidated Fund of India shall be paid each year to the States of Assam, Bihar, Orissa and West Bengal as may be prescribed either by the President before the appointment of the Finance Commission or by the Commission itself. The grant-in-aid so prescribed shall continue to be a charge on the Consolidated Fund of India so long as any export duty on jute or jute products continues to be levied by the Government of India, or until the expiration of ten years from the commencement of the Constitution, whichever is earlier.

Surcharges on Duties and Taxes

The Union Government (notwithstanding the provisions of Articles 269 and 270) may levy duties or taxes by a surcharge for purposes of the Union; and the whole proceeds of any surcharge shall form part of the Consolidated Fund of India. Such a proposal was made by the White Paper (December, 1931) which proposed that the Federal Government may be empowered to impose a surcharge on taxes on income, the proceeds of which were to be devoted solely to Federal purposes. Similarly, the Provincial legislatures were to be empowered to impose a surcharge, not exceeding 12½ per cent, on the taxes levied on the personal income of persons resident in the Provinces and to retain the proceeds for their own purpose. The Joint Committee (1934), however, did not favour the levy of the surcharges and they were not permitted

by the Act of 1935. The provisions of the above Articles have given powers to the Union Parliament alone to levy these surcharges, but no corresponding power has been given to the States. This weakens the position of the States in financial matters and they must look to the Union for grants.

Taxes on Professions, Trades, Callings, and Employments

The legislature of a State (notwithstanding anything contained in Article 246) shall not pass a law regarding taxes on professions, trades, callings and employments, the total amount payable in respect of any one person to the State or to any one municipality, district board, local board, or other local authority in the State, shall exceed Rs. 250/- per annum.

Bills Affecting Taxation in which States are Interested

The Constitution requires the prior recommendation of the President to Bills which affect taxation in which States are interested. Thus no Bill or amendment which imposes or varies the meaning of the expression 'agricultural-income', or which affects the principle on which moneys are or may be distributed to States or which imposes any surcharge for the purposes of the Union (Article 271) shall be introduced or moved in the House of Parliament except on the recommendation of the President. The Article safeguards the interests of the States in those fields of taxation in which they are interested by making it obligatory on the part of the Union Government to obtain the recommendation of the President before introducing such a Bill which may change their financial position.

VII

THE FINANCIAL SYSTEM AND ADMINISTRATION

§ 1. *INTRODUCTORY*

In most federal constitutions there are three fundamental provisions in the field of financial administration which safeguard the interests of taxpayers. Briefly, the rights of the taxpayers are that:

(1) No tax shall be levied or collected unless it is approved by the representatives of the people;

(2) No expenditure out of public revenue is incurred unless it is sanctioned by Parliament; and

(3) The executive spends the public revenue exactly in the manner as passed by Parliament. In order to check the abuse of power on the part of the executive, the Auditor-General audits the accounts of the Government to place before the Legislature a report to show that the executive has spent the money for the purposes for which Parliament had sanctioned it.

The Constitution has provided safeguards for the above three rights. Thus, 'No tax shall be levied or collected except by authority of law'.[1] Similarly, no moneys out of the Consolidated Fund of India or the Consolidated Fund of a State shall be appropriated except in accordance with law, and for the purpose and in the manner as passed by the Legislature.[2] Again, the Comptroller and Auditor-General of India has been given duties and powers to check the expenditure of the Government of India and the State Governments.[3] The Report of the Comptroller and Auditor-General shall be laid before each of the Houses of Parliament and the Legislatures of the States in order that the representatives of the people may have the chance to see that public revenues have not been diverted from the purposes of expenditure for which they were allocated by the House.

[1] *See* Article 265.
[2] *See* Article 266.
[3] *See* Article 148.

The scope of this chapter is as follows:

First, an account shall be given of the procedure in respect of Money Bills in the case of the Union and State Legislatures. This shall be followed by provisions relating to the duties and powers of the Comptroller and the Auditor-General.

Summary of Financial Procedure in the Union Parliament

Before we describe in any detail the special procedure for the passing of Money Bills in the Union Parliament, it is desirable to summarise briefly the various stages of financial machinery as followed in the Indian Parliament. These stages are as follows:

A. *Presentation of the Annual Financial Statement*

After the estimates have been prepared by the various departments of the Government, the Annual Financial Statement for the coming year is laid before both the Houses of Parliament. The Annual Financial Statement shall contain the estimates of the receipts as well as the expenditure of the Union Government. The expenditure shall be classified as follows:

(*i*) Expenditure charged upon the Consolidated Fund and items which are not so charged; and

(*ii*) Expenditure on revenue account and on other accounts.

After the Financial Statement has been presented to the Houses a general discussion takes place in both the Houses. It may be pointed out that no item of expenditure is exempt from general discussion. Expenditure charged upon the Consolidated Fund though not subject to the vote of the House, is equally open for discussion. The general discussion is upon matters relating to policy including a review and criticism of the administration of the Government and its departments. The members of the Legislature, thus, have a chance of ventilating the grievances of the taxpayers.

B. *Votes of the Demands by the House of the People*

In the House of the People, after the general discussion has taken place, the estimates shall be submitted to the House in the form of demands for grants on particular heads of

expenditure followed by the vote of the House for each item of expenditure. The House of the People possesses three powers in this respect: (*i*) to assent to the demand; (*ii*) to refuse it; and (*iii*) to reduce it. It will thus appear that the House has no power to increase the demand or to change the allocation of expenditure from one head to another. The voting of the demands for grants does not take place in the Council of States.

C. *The Appropriation Act*

After the grants have been voted by the House of the People, they shall be presented to the House in the form of an Appropriation Act. Under the Government of India Act, 1935, after the demands had been voted by the Legislature, the Governor-General authenticated the Finance Bill under his signature. Where the expenditure had been refused or reduced by the Legislature, but was in his opinion necessary for the discharge of his special responsibilities, he restored the expenditure in the original form as put forth before the House. In England, the grants, as voted by the House of Commons, are embodied in a Money Bill and passed by Parliament. Under the Constitution, the President has no power to override the vote of the House of the People. The Appropriation Act is the sole legal authority for any appropriation of money out of the Consolidated Fund of India.

D. *The Finance Act*

The new tax proposals of the budget shall be embodied in another bill and passed as the Annual Finance Act of the year.

§ 2. *FINANCIAL ADMINISTRATION*

Consolidated Fund and Contingency Fund

The Constitution has created two funds in the case of the Government of India, viz.: (1) The Consolidated Fund, and (2) The Contingency Fund. Similar Funds have also been created in the case of the States. The whole or part of the net proceeds of certain taxes and duties and all revenues

received by the Government of India, and all loans raised by it by the issue of treasury bills, loans, or ways-and-means advances, in short, all moneys received or owned by the Government of India, shall form one Consolidated Fund to be entitled 'the Consolidated Fund of India'.

Similarly all revenues, loans, or ways-and-means advances and all moneys received by the States from the Government of India shall be entitled 'the Consolidated Fund of State'.[1]

Parliament may by law establish a Contingency Fund in the nature of an imprest to be entitled 'the Contingency Fund of India', into which shall be paid from time to time such sums as may be determined by laws passed by Parliament. The Fund shall be placed at the disposal of the President to enable him to make advances for the purposes of meeting unforeseen expenditure, pending authorisation for such expenditure by Parliament under the provisions of Articles 115 or 116.

The Legislature of a State may also establish a similar Contingency Fund in the nature of an imprest to be entitled 'the Contingency Fund of the State'. The Fund shall be placed at the disposal of the Governor of the State to enable him to make advances for the purpose of meeting unforeseen expenditure pending its authorisation by the Legislature of the States under Articles 205 or 206.

The Consolidated Fund is the foundation-stone of financial control in England. All the public revenues received by the State are paid into the Consolidated Fund which is kept in the Bank of England, and no amount can be withdrawn except under the authority of an Act of Parliament. Similarly the Australian Constitution provides: 'All revenues or moneys raised or received by the Executive Government of the Commonwealth shall form one Consolidated Revenue Fund, to be appropriated for the purposes of the Commonwealth in the manner and subject to the charges and liabilities, imposed by the Constitution'. (Section 81).

Under English financial practice, besides the Consolidated Fund there is also the Civil Contingency Fund, the amount of which is fixed by statute. The Fund provides expenditure

[1] *See* Article 266.

for: (i) established services where the grant has not yet been formally voted; (ii) departments for which Parliament has made no provisions in the estimates for the year; and (iii) departments which have exhausted the sums appropriated under votes. The moneys spent by the Government from this Fund are later voted by Parliament and then repaid to the Fund either before or after the close of the financial year. The accounts of the Fund are also scrutinised by the Public Accounts Committee. Under the Constitution a Contingency Fund has been constituted to enable the Government of India and State Governments to meet unforeseen expenditure, pending authorisation of such expenditure, in the shape of supplementary, additional or exceptional grants by the House of the People or the Legislative Assembly of the State.

The custody of the Consolidated Fund and the Contingency Fund of India, the payment of moneys into such Funds, the withdrawal of moneys from them and all transactions connected with them shall be regulated by laws made by Parliament. The President is authorised, till such rules are made by Parliament, to regulate the custody of such Funds by rules made by him.[1]

The custody of the Consolidated Fund and the Contingency Fund of a State and all the transactions, the payments of money into such Funds, the withdrawal of money from them shall be regulated by laws made by the Legislature of the States and until such laws are framed, by rules made by the Governor of the State.[2]

Initiation of Money Bills

The power of initiating Money Bills is, more or less, common to all leading constitutions. The rule that Money Bills may originate in the House of Commons in England, is not sanctioned by any statute, but is the result of the tenacious and continuous struggle between the people and the Crown, which had its first victorious affirmation in the Magna Carta of 1215, and ended in 1688 with the recognition of the Sovereignty of Parliament in the matter of levying taxes. The

[1] *See* Article 283(1).
[2] *See* Article 283(2).

House of Lords, however, had the power to amend or reject Money Bills passed by the House of Commons. This power of the House of Lords was stopped by the Parliament Act, 1911 under which the Lords can neither amend nor reject a Money Bill; the utmost the House of Lords can do is to prevent a Money Bill from becoming law for a period of one month. Section 1(I) of the Parliament Act, 1911 lays down:

> If a Money Bill, having been framed by the Commons and sent to the Lords at least one month before the end of the session, is not passed by the Lords without amendment within one month after it has been sent up, the Bill, unless the Commons direct to the contrary, shall be presented to the King and become a statute on receipts of the Royal Assent without the consent of the Lords.

The Indian Constitution has followed the practice of other constitutions and Money Bills in the case of the Union can only be introduced in the House of the people. In States where there is a Legislative Council, besides a Legislative Assembly, a Money Bill can only be introduced in the Legislative Assembly.

Definition of 'Money Bills'

A Bill is deemed to be a Money Bill if it contains provisions dealing with any or all of the following matters namely:[1]

(*a*) the imposition, abolition, remission, alteration or regulation of any tax;

(*b*) the regulation of the borrowing of money or the giving of any guarantee by the Government of India, or the amendment of the law with respect to any financial obligations undertaken or to be undertaken by the Government of India;

(*c*) the custody of the Consolidated Fund or the Contingency Fund of India, the payment of moneys into or the withdrawal of moneys from any such fund;

(*d*) the appropriation of moneys out of the Consolidated Fund of India;

(*e*) the declaring of any expenditure to be expenditure

[1] *See* Article 110. For the definition of Money Bills in States, *see* Article 199. Article 110 corresponds exactly with Article 199.

charged on the Consolidated Fund of India or the increasing of the amount of any such expenditure;

(*f*) the receipt of money on account of the Consolidated Fund of India or the public accounts of India or the custody or issue of such money or the audit of the accounts of the Union or of a State.

(*g*) any matter, incidental to any of the matters specified in clauses (*a*) to (*f*) above.

Procedure for Passing Money Bills

Money Bills in the case of the Union shall not be introduced in the Council of States.[1]

After a Money Bill has been passed by the House of the People it shall be transmitted to the Council of States for its recommendations and the Council of States shall within a period of fourteen days from the date of the receipt of the Bill, return the Bill to the House of the People with its recommendations and the House of the People may thereupon either accept or reject all or any of the recommendations of the Council of States.

If the House of the People accepts any of the recommendations of the Council of States, the Money Bill shall be deemed to have been passed by both Houses with the amendments recommended by the Council of States and accepted by the House of the People.

If the House of the People does not accept any of the recommendations of the Council of States, the Money Bill shall be deemed to have been passed by both Houses in the form in which it was passed by the House of the People without any of the amendments recommended by the Council of States.

If a Money Bill passed by the House and transmitted to the Council of States for its recommendations is not returned to the House of the People within the said period of fourteen days, it shall be deemed to have been passed by both Houses at the expiration of the said period in the form in which it was passed by the House of the People.

[1] *See* Article 109. For the procedure of passing Money Bills in States, *see* Article 198, which corresponds exactly with Article 109.

Annual Financial Statement

The President shall in respect of every financial year cause to be laid before both the Houses of Parliament a statement of the estimated receipts and expenditure of the Government of India for that year. This statement is called the 'Annual Financial Statement'.

The estimates of expenditure embodied in the Annual Financial Statement shall show separately:

(*a*) The sums required to meet expenditure described by the Constitution as expenditure charged upon the Consolidated Fund of India; and

(*b*) the sums required to meet other expenditure proposed to be made from the Consolidated Fund of India.

The Financial Statement shall also distinguish expenditure on revenue account from other expenditure.[1]

Expenditure Charged on the Consolidated Fund

The following expenditure shall be expenditure charged upon the Consolidated Fund of India:[2]

(*a*) the emoluments and allowances of the President and other expenditure relating to his office;

(*b*) the salaries and allowances of the Chairman and the Deputy Chairman of the Council of States and the Speaker and the Deputy Speaker of the House of the People;

(*c*) debt charges for which the Government of India is liable including interest, sinking fund charges and redemption charges, and other expenditure relating to the raising of loans and the service and redemption of debt;

(*d*) (*i*) the salaries, allowances and pensions payable to or in respect of Judges of the Supreme Court;

(*ii*) the pensions payable to or in respect of Judges of the Federal Court;

(*iii*) the pensions payable to or in respect of Judges of any High Court which exercises jurisdiction in relation to any area included in a Governor's Province of the Dominion of India.

(*e*) the salary, allowances and pension payable to or

[1] *See* Article 112. Compare this Article with Article 202 for the States.
[2] *See* Article 112. *See* Article 202(3) for the States.

in respect of the Comptroller and Auditor-General of India;

(*f*) any sums required to satisfy any judgement, decree or award of any court or arbitral tribunal;

(*g*) any other expenditure declared by the Constitution or by Parliament by law to be so charged.

Broadly speaking, the expenditure 'charged on the Consolidated Fund of India', more or less corresponds to the Consolidated Fund Service of England. The enumeration of the items charged on the Consolidated Fund is not exhaustive and Parliament is empowered to add more to the list by law.

The fundamental reason for making some expenditure free from the vote of the House, is that the persons who have been charged with the responsibilities for the carrying out of the functions of the Government should be independent of the vote of the House. A disproportionately higher expenditure charged on the Consolidated Fund, however, reduces the power of the Legislature in controlling public expenditure.

No money shall be withdrawn from the Consolidated Fund of India unless it was included in the Appropriation Bill as passed by the House of the People.[1]

Importance of Supplementary Grants

Supplementary grants occupy an important place in financial administration. In England, a supplementary grant may be presented either for a further grant to service already sanctioned by Parliament, in addition to the sum already demanded for the current financial year, or for a grant caused by a fresh occasion for expenditure that has arisen since the presentation of the sessional estimates, such as expenditure newly imposed upon the executive government by statute, or to meet the cost created by an unexpected emergency, such as an immediate addition to an existing service, or the purchase of land, or of a work of art. The need for a supplementary grant to an existing service is not infrequently caused by the system in force to ensure the control of Parliament over public expenditure. To provide for the early presentation of the annual estimates, the departments are obliged to compute in

[1] *See* Article 114. *See* Article 203 in the case of the States.

the month of November their anticipated expenditure for the ensuing financial year, dating from the coming April. Fallibility must attend calculations which range over sixteen months in advance: too often the estimates do not give a correct picture of the amount actually needed by the department.

Supplementary grants, thus, fulfil a useful role in Parliamentary budgetary practice. They check the executive from increasing the departmental expenditure beyond what was passed at the time of the annual financial grants. Again, the Legislature has the power (*i*) to assent to the demand; (*ii*) to refuse it; or (*iii*) to reduce it. The members also have the right to ventilate their grievances against the administration of the government as a whole or, that of a particular department which has put forth the demand for additional grants.

The procedure for passing of supplementary estimates and excess grants is the same as that for demands for grants subject to such adaptations as the Speaker may deem necessary.[1]

Supplementary, Additional, or Excess Grants

A Supplementary Financial Statement shall be laid before both the Houses of Parliament showing the estimated amount of that expenditure for sanction by the House of the People under the following conditions. If during the course of the year (*i*) the amount authorised by any law made in accordance with the provisions of Article 114 to be expended for a particular service for the current financial year is found to be insufficient for the purposes of that year or when a need has arisen during the current financial year for supplementary or additional expenditure upon some new service not contemplated in the annual financial statement for that year; or (*ii*) any money has been spent on any service during a financial year in excess of the amount granted for that service.[2]

The House of the People, however, has been given power to make any grant in advance for meeting unforeseen expenditure for a part of any financial year pending the completion of the procedure prescribed in Article 113 for the voting

[1] *See* Article 155. For the States *see* Article 205.
[2] *See* Article 115. For the States *see* Article 205.

of such grant and the passing of the law in accordance with the provisions of Article 114 in relation to that expenditure. The grant may relate for meeting an unexpected demand upon the resources of India when on account of the magnitude or the indefinite character of the service the demand could not be stated with the details ordinarily given in an annual financial statement. The Parliament, in such cases, shall have power to authorise by law the withdrawal of moneys from the Consolidated Fund of India for the purposes for which the said grants are made.[1]

Borrowing by the Government of India and the States

The executive power of the Union extends to borrowing upon the security of the Consolidated Fund of India. Similarly a State may borrow within the territory of India upon the security of the Consolidated Fund of the State within such limits as may from time to time be fixed by the Legislature of such a State.

The Government of India may, subject to such conditions as may be laid down by or under any law made by Parliament, make loans to any State, and any sums required for the purpose of making such loans shall be charged on the Consolidated Fund of India.

A State may not without the consent of the Government of India raise any loan if there is still outstanding any part of a loan which has been made to the State by the Government of India or by its predecessor Government, or in respect of which a guarantee has been given by the Government of India or by its predecessor Government.

§3. *COMPTROLLER AND AUDITOR-GENERAL OF INDIA*

The Comptroller and Auditor-General has two important functions to perform: (*i*) As Comptroller it is his duty to see that no money is drawn out of the Consolidated Fund without statutory authority; and (*ii*) as Auditor-General of the public accounts it is his duty to see that the public revenue

[1] *See* Articles 116 and 206 for the States.

is spent in accordance with grants as passed by Parliament. The Constitution has provided for the appointment of the Comptroller and Auditor-General to perform the above two functions.

Appointment of Comptroller and Auditor-General

For the purpose of securing the highest standards of financial integrity of the administration and watching the interest of the taxpayer and also for purposes of Legislative control over the entire executive Government and its officers, the Constitution safeguards the independence and freedom of the Comptroller and Auditor-General in a variety of ways. Article 148 of the Constitution provides that the Comptroller and Auditor-General of India shall be appointed by the President and shall only be removed from office in like manner and on like grounds as a Judge of the Supreme Court. It also provides that he would not be eligible for any other office either under the Government of India or the Government of any State and that the administrative expenses of his office, including all salaries, allowances and pensions payable to or in respect of persons serving in that office, shall be charged to the Consolidated Fund of India.

The salary and other conditions of service of the Comptroller and Auditor-General shall be such as may be determined by Parliament by law, and until they are so determined, shall be specified in the Second Schedule of the Constitution.[1] These provisions are effective until an Act to determine the salary and other conditions of service of the Comptroller and Auditor-General is passed by Parliament. (Article 148, Clause 3). Under sub-paragraph (3) of paragraph 12 of the Second Schedule to the Constitution, the rights in repsect of leave of absence and pension and the other conditions of service of the Comptroller and Auditor-General shall be governed, or shall continue to be governed, as the case may be, by provisions which were applicable to the Auditor-General of India immediately before the commencement of the Constitution.[2]

[1] These provisions are contained in the Audit and Accounts Order, 1936, as adapted by the India (Provisional Constitution) Order, 1947.

[2] The Comptroller and Auditor-General is the administrative head of the Indian Audit and Accounts Department. His administrative powers will be governed by rules made by the President after consultation with the former, as provided

Duties of the Comptroller and Auditor-General

The functions of the Comptroller and Auditor-General are derived in the main from the provisions of Articles 149 to 151 of the Constitution. Article 149 of the Constitution envisages an Act of Parliament to regulate the duties and powers of the Comptroller and Auditor-General in relation to the accounts of the Union and of the States and of any other authority or body and until such a provision is made it lays down that the Comptroller and Auditor-General shall perform such duties and exercise such powers in relation to the accounts of the Union and of the States as were conferred on or exercisable by the Auditor-General of India immediately before the commencement of the Constitution in relation to the accounts of the Dominion of India and of the Provinces respectively.[1]

The duties and powers of the Comptroller and Auditor-General in relation to accounts of the Union and State Governments are laid down in Article 150 of the Constitution and in paragraphs 11, 12 and 17 of the Audit and Accounts Order, 1936 as adapted by the India (Provincial Constitution) Order, 1947. Article 150 of the Constitution empowers the Comptroller and Auditor-General with the approval of the President to prescribe the form in which the accounts of the Union and of the States are to be kept.

It is one of the duties of the Comptroller and Auditor-General to prepare each year comprehensive accounts of the receipts and expenditure of each Government, classifying the

in Clause (5) of Article 148 of the Constitution. He derives his financial powers by delegation from the Union Government. His powers, administrative as well as financial, are detailed in the compilation known as the 'Auditor-General's Manual of Standing Orders'.

[1] The duties and powers of the Auditor-General of India in relation to the accounts of the Dominion of India and of the Provinces immediately before the commencement of the Constitution were prescribed in the Audit and Accounts Order, 1936, as adapted by the India (Provisional Constitution) Order, 1947, and in the Initial Subsidiary Accounts Rules issued by the Governor-General in pursuance of paragraph II(3) of the former order. By virtue of the provisions of Article 149 of the Constitution, the relevant provisions of the former Order continue in force and regulate the duties and powers of the Comptroller and Auditor-General in relation to the accounts of the Union and of the States until an Act is passed by Parliament under this Article.

See *An Introduction to Indian Government Accounts and Audit*, (Second Edition), 1950, pp. 15-16.

transactions under respective heads and to submit them to the government concerned. These accounts are designated the Finance Accounts. Besides these accounts, the Comptroller and Auditor-General has also to submit annually, to each government in respect of accounts kept by him, Appropriation Accounts, that is, accounts relating to expenditure brought into account during a financial year to the several items specified in the Schedules to Appropriation Acts passed in accordance with the provisions of Articles 114 and 204 of the Constitution.

The Comptroller and Auditor-General has also to prepare annually for submission to the President a General Financial Statement incorporating a summary of the accounts of the Union and of all the States for the preceding financial year and particulars of their balances and outstanding liabilities and containing such other information regarding their financial position as the President may direct to be included in the Statement.

Duties of the Comptroller and Auditor-General in regard to Audit

The duties of the Comptroller and Auditor-General in regard to audit are given in paragraph 13 of the Audit and Accounts Order, 1936, as adapted in 1947. The fundamental provisions relating to audit are as follows:

(1) It shall be the duty of the Auditor-General:

(*i*) to audit all expenditure from the revenues of the Dominion and of the Provinces and to ascertain whether moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it.

(*ii*) to audit all transactions of the Dominion and of the Provinces relating to debt deposits, sinking funds, advances, suspense accounts and remittance business.

(*iii*) to audit all trading, manufacturing and profit and loss accounts and balance sheets kept by order of the Governor-General or of the Governor

of a Province in any department of the Dominion or of the Province; and in each case to report on the expenditure, transactions or accounts so audited by him.

(2) The Auditor-General may with the approval of, and shall if so required by, the Governor-General or the Governor of any province audit and report on:

(*i*) the receipts of any department of the Dominion or as the case may be, of the Province;

(*ii*) the accounts of stores and stock kept in any office or department of the Dominion or, as the case may be, of the Province.[1]

Audit Reports

Under Article 151 of the Constitution the Comptroller and Auditor-General submits the following reports to the Union and States Governments:

(*a*) Audit Report on the Appropriation Accounts, and

(*b*) Audit Report on the Finance Accounts.

He also submits separate reports on the three principal spending departments of the Union—the Defence, the Railway and the Posts and Telegraphs Departments. The transactions of the remaining departments of the Union are dealt with in a single volume. There are separate reports on the Finance Accounts of the States.

The Audit Report on the Appropriation Accounts contains such comments on the regularity and and propriety of expenditure as are deemed necessary and proper as a result of audit investigation. It also brings to the notice of the Legislature the results of the audit of all trading, manufacturing and profit and loss accounts and balance sheets kept in respect of Government commercial or quasi-commercial undertakings. The object of the Audit Report on the Finance Accounts is to present to the Legislature with

[1] For a more detailed account of the duties and powers of the Comptroller and Auditor-General, see *An Introduction to Indian Government Accounts and Audit*, 1950, Chapter 3.

The language in Clause (1) of the paragraph of the Audit and Accounts Order, quoted above, follows closely the wording of the Exchequer and Audit Department Act of the United Kingdom.

the accounts of the entire receipts and outgoings of the Government for each financial year a report on the financial results disclosed by the different accounts and other data coming under examination, that is to say, the revenue and capital accounts, and the accounts of the public debt and of the liabilities and assets of the Government concerned as deduced from the balances recorded in the books of the Accounts Office and from other information. It supplements the Audit Report on Appropriation Accounts.

The above Reports relating to the accounts of the Union are submitted to the President who causes them to be laid before the Parliament. The Report relating to the accounts of the State are submitted to the Governor of the State who has them to be laid before the Legislature of the State.

The procedure which Parliament and the State Legislatures follow in dealing with these Reports is regulated by rules framed by them under Article 118 (1) and 208 (1) of the Constitution. The Audit Report on the Appropriation Accounts and the Audit Report on the Finance Accounts are considered by a committee of the Legislature known as the Committee on Public Accounts.

Functions of the Public Accounts Committee

The functions of the Public Accounts Committee of Parliament as laid down in 'the Rules of Procedure and Conduct of Business in Parliament' are as follows:[1]

(1) In scrutinising the Appropriation Accounts of the Union Government and the report of the Comptroller and Auditor-General thereon, it shall be the duty of the Public Accounts Committee to satisfy itself:

(*a*) that the expenditure conforms to the authority which governs it; and

(*b*) that every re-appropriation has been made in accordance with the provisions made in this behalf in the Appropriation Act, or under rules framed by competent authority under the provisions of the said Act.

[1] See *An Introduction to Indian Government Accounts and Audit,* (Second Edition), 1950, p. 117.

(2) It shall also be a duty of the Public Accounts Committee[1]

(*a*) to examine such trading, manufacturing and profit and loss accounts and balance sheets, as the President may have required to be prepared, and the Comptroller and Auditor-General's Report thereon; and

(*b*) to consider the report of the Comptroller and

[1] The functions of the Committee of Public Accounts of the Provincial Parliament are laid down in Rules 143-4 of the Rules of Procedure and Conduct of Business in Parliament. These rules are as follows:

"143. Committee on Public Accounts.

1. As soon as may be after the commencement of the first session of Parliament, a committee on Public Accounts shall, subject to the provisions of this rule, be constituted.
2. The functions of the Committee shall be to examine the accounts showing the appropriation of the sums granted by Parliament to meet the expenditure of the Government of India and such other accounts laid before Parliament as the Committee may think fit.
3. The Committee on Public Accounts shall consist of not more than fifteen members, who shall be elected by Parliament from amongst its members according to the principle of proportional representation by means of the single transferable vote.
4. The terms of the office of the Committee shall be one year.
5. Casual vacancies of the Committee shall be filled as soon as possible after they occur by election in the manner aforesaid, and any person elected to fill such vacancy shall hold office for the period for which the person in whose place he is elected would, under the provisions of this rule, have held office.
6. In order to constitute a meeting of the Committee the quorum shall be four.
7. (*a*) The Chairman of the Committee shall be appointed by the Speaker from amongst the members of the Committee. He shall be appointed Chairman of the Committee.
   (*b*) If the Chairman is for any reason unable to act, the speaker may similarly appoint another Chairman in his place.
   (*c*) If the Chairman is absent from any meeting, the Committee shall choose another member to act as the Chairman of the meeting.
8. In the case of an equality of votes on any matter, the Chairman shall have a second or casting vote."

"144. Control of Committee on Public Accounts.

1. In scrutinising the Appropriation Accounts of the Government of India, the Report of the Comptroller and Auditor-General thereon, it shall be the duty of the Committee on Public Accounts to satisfy itself:
   (*a*) that the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged;
   (*b*) that the expenditure conforms to the authority which governs it; and
   (*c*) that every re-appropriation has been made in accordance with the provisions made on this behalf in the Appropriation Act, or under rules framed by competent authority under the provisions of the said Act: provided that the provision made in cl. (*c*) above shall not apply to any accounts prior to the year 1950-51.

Auditor-General in cases where the President may have required him to conduct an audit of any receipts or to examine the accounts of stores and stock.

The Public Accounts Committee is not an executive body and has no power to disallow any item or to issue an order even on the clearest evidence of extravagance or irregularities. It can only call attention to irregularities and record its findings and recommendations.

The Reports on the Appropriation Accounts and the Finance Accounts are documents of the highest importance and should receive the personal attention of the members of the Legislature. The control which the Legislature will exercise over the Finances of the Government will depend upon the effectiveness of the help rendered by these Reports.

VIII

FINANCIAL INTEGRATION

Introduction

The history of financial relations between the Centre and the States may broadly be divided into four well-marked periods: (i) from the reforms of Lord Mayo (1870) to the passing of the Government of India Act, (1919); (ii) from 1919 to 1935 during which the Government of India Act remained in force; (iii) the period covered from April 1, 1937 to the coming into force of the Constitution of India early in 1950; and (iv) the period subsequent to the commencement of the Constitution. The history of financial integration during the first three periods has already been described in the previous chapters. An attempt will be made in this chapter to describe the problems of financial integration between the Centre and States in the light of the Articles of the Constitution. The chapter is divided into three sections. In Section 1 the financial arrangements during the period 1947-52 are described. In Section 2 the recommendations of the First Finance Commission are stated. Section 3 examines the recommendations of the Second Finance Commission.

§ 1. *FINANCIAL INTEGRATION, 1947-52*

Soon after Independence the adjustment in financial arrangements between the Government of India and the States had become necessary especially in the field of distribution of the income-tax and the jute export duty. In regard to income-tax the basic scheme of Sir Otto Niemeyer was retained. The Government of India reduced the shares of the divided Provinces of Bengal and the Punjab in proportion to population and the released percentages of Sind and the North-West Frontier Province were pooled for redistribution. The provincial shares were re-fixed after distributing the lapsed

quota among the Indian Union Provinces, including West Bengal and the Punjab, according to population, with a readjustment in favour of West Bengal and a minor adjustment in favour of Assam. The provincial shares thus fixed, which governed the distribution between 15th August 1947 and 31st March 1950, were as follows:

	Per cent
Bombay	21
Madras	18
West Bengal	12
Uttar Pradesh	19
Madhya Pradesh	6
Punjab	5
Bihar	13
Orissa	3
Assam	3

As regards the jute duty, the provincial share was reduced from 62½ per cent to 20 per cent, roughly in proportion to the jute-growing area which came to be included in Pakistan, but the basis of the distribution of the shares among the States was left undisturbed.

Sarkar Committee

The financial provision in the Draft Committee was referred to an Expert Committee under the Chairmanship of Shri N. R. Sarkar. The recommendations of the Committee are important as it had suggested some basic principles for the division of taxes and the appointment of a Finance Committee. The Committee recommended that the whole of the income-tax, including corporation tax and income-tax on federal emoluments, should be shared between the Centre and the units except to the extent of the tax attributable to Centrally administered areas. It suggested that the provincial share should be fixed at 60 per cent and allocated among the Provinces in the following manner: 20 on the basis of population and 35 on the basis of collection, the remaining 5 being used for mitigating hardships that might arise as a result of the application of the other two criteria. As regards the jute export duty, the Committee recommended that the existing

arrangements for the sharing of the net proceeds with the Provinces should be terminated as, in its view, export duties were unsuitable for sharing with the Provinces. However, in order to avoid hardship to the four jute-growing Provinces which were receiving a share of the duty they proposed that fixed grants-in-aid of Rs. 1 crore to West Bengal, Rs. 15 lakhs to Assam, Rs. 17 lakhs to Bihar and Rs. 3 lakhs to Orissa be given every year as 'compensation' for a period not exceeding ten years or till the export duties on jute were abolished. Another recommendation of the Committee relates to Central excise duties. The Committee remarked that the Provincial Governments had been almost unanimous in demanding some share in the excises and considered the problem as being not only one of finding more resources for the units but also one of imparting a better balance to their revenue structure. The Committee suggested that the Provincial Governments should be given a share in one of the important Central excises on a commodity not receiving tariff protection, viz. tobacco, and accordingly recommended that 50 per cent of the net proceeds of the excise duty on tobacco be distributed to the Provinces on the basis of estimated consumption. The Committee also recommended that export duties should be exclusively a Central source of revenue. However, provision should be made for the payment of grants-in-aid to the States of West Bengal, Bihar, Assam and Orissa in lieu of their share of the jute export duty; the amounts were, however, left to be prescribed by the President. The Committee is also responsible for the suggestion that a Finance Commission should be set up to deal with, among other things, matters connected with the division of revenues between the Centre and the units and the distribution among the units of their shares.

The Deshmukh Award, 1950

As a Finance Commission could not be set up immediately, the States' share of the income-tax and its distribution and the payments of grants-in-aid under Articles 273 and 275 of the Constitution had to be regulated by Order of the President of the period between the commencement of the Constitution

and the appointment of the Commission. Some of the States had expressed dissatisfaction with the arrangements regarding the allocation of income-tax and the jute export duty made by the Government of India immediately after the Partition. It was, therefore, decided that the matter should be referred to an impartial authority for reconsideration. Towards the end of 1949, Shri C. D. Deshmukh was requested by the Government of India to enquire into and decide these two questions. It was agreed that his decision would be in the nature of a binding award. Shri Deshmukh's enquiry did not cover the determination of the States' share of the tax nor was he requested to deal comprehensively with the problem of the distribution of the States' share among all the States. He confined himself to the reallocation of the percentages released as a result of the Partition from the share of the divided Provinces and the Provinces wholly included in Pakistan. He did not concern himself with determining the shares of the Part B States or the shares allocable in respect of the territories of the former Indian States merged in the Part A States.

In approaching his task, Shri Deshmukh first attempted to estimate as nearly as possible the percentages that might have been allocated by Sir Otto Niemeyer to parts of the Provinces now included in Pakistan had they been in existence as separate Provinces at the time. Having thus determined the aggregate quota available for redistribution, he distributed it largely on the basis of population making minor adjustments for the purpose of rounding off and giving a small weight in favour of the weaker States. In taking population as the basis of reallocation he was influenced by the consideration that any award which gave additional weight to residence would hinder progress towards a general equalisation of the levels of administration which in the prevailing circumstances, he thought was a desirable end. The table below indicates the percentage distribution among the States of their share of income-tax (i) before the Partition, (ii) under the arrangements made by the Government of India immediately after the Partition and (iii) under the award given by Shri Deshmukh:

TABLE XXV

Province		Pre-Partition share, per cent.	Share under Government of India allocation, per cent.	Share under Deshmukh Award, per cent.
Madras	..	15	18	.5
Bombay	..	20	21	21.0
West Bengal	..	20*	12	13.5
Uttar Pradesh	..	15	19	18.0
Punjab	..	8*	5	5.5
Bihar	..	10	13	12.5
Madhya Pradesh	..	5	6	6.0
Assam	..	2*	3	3.0
Orissa	..	2	3	3.0

* relates to the undivided Provinces.

In regard to grants-in-aid in lieu of a share in the export duty on jute and jute-products, Shri Deshmukh observed that the provision in the Constitution 'alters completely the constitutional rationale of the old arrangement', the grants being in effect 'compensation payments' 'constituting a means of financial assistance to the four Provinces'. He recommended that the following grants-in-aid be paid each year to the four States mentioned in Article 273 of the Constitution, until the Finance Commission proposed any revision:

Province		Rupees in lakhs
West Bengal	..	105
Assam	..	40
Bihar	..	35
Orissa	..	5

The Deshmukh Award was given effect to from the 1st April, 1950 and remained in force for the two years ending with the 31st March, 1952.

§2. *THE FIRST FINANCE COMMISSION*

It is desirable to refer briefly to the terms of reference of the first Finance Commission as with the reorganization of the

States the functions of the first Finance Commission are somewhat different from that of the second Commission. Under Article 280 of the Constitution, the Commission was charged with the duty of making recommendations to the President as to:

(*a*) the distribution between the Union and the States of the net proceeds of taxes which are to be, or may be, divided between them under the provisions of Chapter I of Part XII of the Constitution and the allocation between the States of the respective shares of such proceeds;

(*b*) the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India;

(*c*) the continuance or modification of the terms of any agreement entered into by the Government of India with the Government of any State specified in Part B of the First Schedule under clause (1) of Article 278 or under Article 306; and

(*d*) any other matter referred to the Commission by the President in the interests of sound finance.

Besides the President requested the Commission to make recommendations in regard to:

(*a*) the sums to be prescribed by him as grants-in-aid of the revenues of the States of Assam, Bihar, Orissa and West Bengal in lieu of assignment of any share of the net proceeds in each year of the export duty on jute and jute products to these States in accordance with the provisions of Article 273 of the Constitution; and

(*b*) the States in need of assistance and the sums payable to such States as grants-in-aid of their revenues under the substantive portion of clause (1) of Article 275 of the Constitution.

Recommendations of the Commission

The main recommendations of the Commission are summarised below:

(*a*) *Income-tax*

The Finance Commission recommended (1) an increase in the States' share of the net proceeds of income-tax from 50 per cent to 55 per cent, of which four-fifths will be allocated on the basis of population and the balance on the basis of

collection; (2) allocation to the States, on a population basis, of 40 per cent of the net proceeds of Union excise duties on tobacco, matches and vegetable products; (3) an increase in grants-in-aid to Assam, Bihar, Orissa and West Bengal in lieu of a share in the export duty on jute and jute products; and (4) additional general grants-in-aid to certain States which are in need of assistance and special grants to certain less developed States for expansion of primary education facilities.

The allocation of income-tax amongst the States was based, as mentioned above, on population and the collections of income-tax in the respective territories. The percentage shares prescribed for Part A and B States are given below:

Part A States	Per cent	Part B States	Per cent
Assam ..	2·25	Hyderabad ..	4·50
Bihar ..	9·75	Madhya Bharat ..	1·75
Bombay ..	17·50	Mysore ..	2·25
Madhya Pradesh ..	5·25	PEPSU ..	0·75
Madras ..	15·25	Rajasthan ..	3·50
Orissa ..	3·50	Saurashtra ..	1·00
Punjab ..	3·25	Travancore-Cochin ..	2·50
Uttar Pradesh ..	15·75		
West Bengal ..	11·25		

It will be observed that as a result of the recommendations of the Finance Commission, the distribution formula applied uniformly to Part A States, including merged territories, and to Part B States. Unlike the arrangement under the Deshmukh Award whereby net income-tax collected in Part B States and in the territories merged in Part A States was not to be included in the divisible pool, there was a common divisible pool; Part B States were entitled to get their percentage share of income-tax fixed on the same basis as for Part A States or the 'revenue-gap grant' as guaranteed through the federal financial scheme, whichever was. The Finance Commission also recommended the discontinuance of revenue grants payable to Bihar, Bombay, Madhya Pradesh and West Bengal in respect of merged areas in these States.

(b) Union Excise Duties

As regards Union excise duties, the Finance Commission

selected the duties on tobacco, matches and vegetable products for division, on the ground that these commodities were of common and widespread consumption and yield a sizeable and reasonably stable revenue for distribution. The States' share of these duties amounted to 40 per cent of the net proceeds and was distributed amongst them as follows:

Part A States	Per cent	Part B States	Per cent
Assam ..	2·61	Hyderabad ..	5·39
Bihar ..	11·60	Madhya Bharat ..	2·29
Bombay ..	10·37	Mysore ..	2·62
Madhya Pradesh ..	6·13	PEPSU ..	1·00
Madras ..	16·44	Rajasthan ..	4·41
Orissa ..	4·22	Saurashtra ..	1·19
Punjab ..	3·66	Travancore-Cochin ..	2·68
Uttar Pradesh ..	18·23		
West Bengal ..	7·16		

As a corollary to this recommendation, the Commission proposed the stoppage, with effect from April 1, 1953 of the yearly compensation paid to Bombay (Rs. 54 lakhs), Madras (Rs. 56 lakhs), Madhya Pradesh (Rs. 1.5 lakhs) on account, of their regaining from levying a tax on tobacco; these States, however, were free to impose taxes on tobacco.

As a result of the above recommendations, all the States, except Bombay, Punjab, Mysore, Travancore-Cochin and Saurashtra, received a larger share of Central taxes than they received in the past. Mysore, Travancore-Cochin and Saurashtra, however, continued to receive the revenue-gap grants guaranteed to them in lieu of their share in Central revenues, since the former were higher.

(*c*) *Grants-in-aid*

In regard to grants-in-aid, the Commission recommended increased grants to West Bengal, Bihar, Assam and Orissa in lieu of their share of export duty on jute and jute products under Article 273 of the Constitution. These grants amounting to Rs. 1,50 lakhs for West Bengal, Rs. 75 lakhs each for Bihar and Assam and Rs. 1,51 lakhs for Orissa were determined on the basis of the shares of export duty on jute and jute manufactures made over to these States in 1949-50. Grants-in-aid

under the substantive portion of Clause (1) of Article 275 were recommended in the case of 7 States only, after taking into account the budgetary needs of the States, the standard of social services, special obligations, or the burden of national concern or of an abnormal nature imposed on the States and certain broad purposes of national importance. The following table shows the general grants recommended for individual States.

		(Lakhs of rupees)
Assam	..	100
Mysore	..	40
Orissa	..	75
Punjab	..	125
Saurashtra	..	40
Travancore-Cochin	..	45
West Bengal	..	80

The Commission also recommended special grants to 8 States for increasing primary education facilities. These grants, the details of which are given below, were allocated in proportion to the number of children of school-going age not attending school.

(Lakhs of rupees)

		1953-54	1954-55	1955-56	1956-57
Bihar ..	..	41	55	69	83
Madhya Pradesh	..	25	33	42	50
Hyderabad	..	20	27	33	40
Rajasthan	..	20	26	33	40
Orissa ..	..	16	22	27	32
Punjab ..	..	14	19	23	28
Madhya Bharat	..	9	12	15	18
PEPSU ..	..	5	6	8	9
Total	..	150	200	250	300

All these recommendations of the Finance Commission were accepted by the Union Government and, in consequence, the total amount transferred to State Governments by way of grants and shares in tax revenue in a normal year, amounted to Rs. 21 crores more than the annual average of Rs. 65 crores transferred during the three-year period 1949-50 to 1951-52. The net effect of the recommendation of the Commission is summarized in the following table:

TABLE XXVI

	Share of Income-tax and Union Excise	Grants-in-aid under Article 273	General Grants-in-aid under substantive portion of Article 275(I)	'Revenue-Gap Grants'	Total	Primary Education Grants	Grand Total
Assam ..	1,70	75	1,00	..	3,45	..	3,45
Bihar	7,30	75	..	..	8,05	50	8,55
Bombay	11,25	..	..	..	11,25	..	11,25
Hyderabad	3,35	..	..	..	3,35	24	3,59
Madhya Bharat ..	1,35	..	..	..	1,35	11	1,46
Madhya Pradesh ..	3,90	..	..	..	3,90	30	4,20
Madras	11,10	..	..	..	11,10	..	11,10
Mysore	1,70	..	40	1,58[1]	3,68	..	3,68
Orissa	2,65	15	75	..	3,55	19	3,74
Patiala & East Punjab States Union ..	60	..	..	..	60	5	65
Punjab ..	2,40	..	1,25	..	3,65	17	3,82
Rajasthan	2,65	..	..	..	2,65	24	2,89
Saurashtra	75	..	40	1,87[1]	3,02	..	3,02
Travancore-Cochin ..	1,80	..	45	98	3,23	..	3,23
Uttar Pradesh ..	11,70	..	..	..	11,70	..	11,70
West Bengal	7,30	1,50	80	..	9,60	..	9,60
Total ..	71,50	3,15	5,05	4,43	84,13	1,80	85,93

[1] As the share of divisible taxes of these States is expected to be less than the guaranteed 'revenue-gap grants', the States will receive the latter. The balance of these grants after allowing for the share of divisible taxes is shown in this column.

§3. *THE SECOND FINANCE COMMISSION*

The Second Finance Commission was set up in June, 1956. With the reorganisation of the States and the need for additional revenues by the States the terms of reference of the Second Finance Commission are somewhat different from that of the first Commission. The terms of reference of the Commission were (1) the distribution between the Union and the States of the net proceeds of taxes which are to be or may be divided and the allocation of the States' net share among the States; (2) the principles that should govern the grants-in-aid of the revenues of the States by the Centre and the amounts of grants under Article 273 and the substantive portion of Article 275 (1); and (3) the modification, if any, necessary in the rates of interest and the terms of repayment of the loans made to the various States by the Government of India. The taxes, regarding the allocation of which they had to make recommendations, were income-tax, Union excise duties, the estate duty, the tax on railway fares, and additional excise duties proposed to be levied on a few commodities in lieu of sales tax by the States. Its Report was submitted in September, 1957.

The main recommendations of the Commission are stated in the following pages.

Income-Tax

Under Article 270 of the Constitution, the Commission was required to make recommendations in regard to (*a*) the percentage of net proceeds of income-tax to be assigned to the States; (*b*) the distribution among them of the States' share and (*c*) the percentage of the net proceeds which shall represent the proceeds attributable to Union territories. The recommendations of the Commission are summarized below:

As regards the percentage of net proceeds in any financial year of taxes on income other than agricultural income to be assigned to the States, the Commission recommended an increase from 55 per cent to 60 per cent on the share of the States. The Commission held the view that the actual

distribution of the share assigned to the States should be on the basis of population, thus altogether eliminating the factor of collection. However, they felt that such an elimination of the factor of collection has to be by stages and hence they proposed that the distribution of the States' share should be 10 per cent on the basis of *collection* and 90 per cent on the basis of *population*, as compared to 20 per cent and 80 per cent recommended by the First Finance Commission. The percentage of the shares prescribed for each State based on the 1951 census figures of population are as follows:

TABLE XXVII

State	Percentage
Andhra Pradesh	8.12
Assam	2.44
Bihar	9.94
Bombay	15.97
Kerala	3.64
Madhya Pradesh	6.72
Madras	8.40
Mysore	5.14
Orissa	3.73
Punjab	4.24
Rajasthan	4.09
Uttar Pradesh	16.36
West Bengal	10.08
Jammu and Kashmir	1.13

Union Excise Duties

Prior to April 1, 1952, no excise duty was shared between the Union and the States. However, the first Finance Commission had recommended that with effect from 1952-53, 40 per cent of the net proceeds of Union excise duties on tobacco (including manufactured tobacco), matches and vegetable products should be distributed among the States on the basis of population. The Second Finance Commission has recommended that: (i) to the three duties should be added the duties on sugar, tea, coffee, paper and vegetable

non-essential oils; (ii) the share of the States should be reduced to 25 per cent; and (iii) 90 per cent of the States' share of Union excise duties should be distributed on the basis of population, the balance being used for adjustments. The reduction in the share now allocated to the States out of the duties on tobacco, vegetable products and matches will be more than made good by the widening of the range of divisible duties and each State will receive a larger sum from this source than at present. The percentages recommended are given below:

TABLE XXVIII

State	Percentage
Andhra Pradesh	9.38
Assam	3.46
Bihar	10.57
Bombay	12.17
Kerala	3.84
Madhya Pradesh	7.46
Madras	7.56
Mysore	6.52
Orissa	4.46
Punjab	4.59
Rajasthan	4.71
Uttar Pradesh	15.94
West Bengal	7.59
Jammu and Kashmir	1.75

Additional Duties of Excise. The Government of India, in consultation with the State Governments, decided that an additional excise duty should be levied on mill-made textiles, sugar and tobacco (including manufactured tobacco), in replacement of the sales taxes levied by a State Government, the net proceeds be distributed among the States, subject to the present income derived by each of the States being assured to it. The Finance Commission was requested to suggest principles of distribution of this proposed tax among the States and the amount assured to each State.

The Commission has suggested that one per cent of the net proceeds from these taxes be assigned to Union Territories and 1¼ per cent to Jammu and Kashmir. The Commission has arrived at the share of individual States largely on the basis of consumption figures, using population as a correctional factor, as the data on consumption were found defective.

After deducting the shares of Union territories and Jammu and Kashmir from the proceeds of the duties, from the balance, according to the Commission, the following amounts are to be paid to the States to represent their present income. Since the Commission was not sure whether to take all the commodities together or give separate figures for each they have made recommendations for the three commodities separately and for all of them together.

TABLE XXIX

(Rupees in lakhs)

State	Amount Guaranteed to States			
	Mill-made textiles	Sugar	Tobacco	All the three combined
Andhra Pradesh ..	120	40	75	235
Assam ..	40	15	30	85
Bihar ..	80	30	20	130
Bombay ..	600	245	115	960
Kerala ..	38	20	37	95
Madhya Pradesh ..	83	40	32	155
Madras ..	168	60	57	285
Mysore ..	48	25	27	100
Orissa ..	50	20	15	85
Punjab ..	95	50	30	175
Rajasthan ..	50	25	15	90
Uttar Pradesh ..	400	112	63	575
West Bengal ..	204	36	40	280
	1976	718	556	3250

The remainder is to be distributed in percentage ratios as given on the next page.

TABLE XXX

States	Percentage Recommended			
	Mill-made textiles	Sugar	Tobacco	All the three combined
Andhra Pradesh ..	7.38	6.65	10.47	7.81
Assam ..	2.72	2.55	2.98	2.73
Bihar ..	11.19	8.20	8.90	10.04
Bombay ..	16.46	20.17	17.41	17.52
Kerala ..	3.10	3.03	3.43	3.15
Madhya Pradesh ..	6.97	7.67	7.10	7.16
Madras ..	7.26	7.43	9.53	7.74
Mysore ..	4.98	5.13	5.58	5.13
Orissa ..	3.32	2.87	3.21	3.20
Punjab ..	5.56	7.21	4.36	5.71
Rajasthan ..	4.36	4.81	3.59	4.32
Uttar Pradesh ..	18.19	15.63	16.13	17.18
West Bengal ..	8.51	8.65	7.31	8.31

Estate Duty. Under Article 269 of the Constitution, an estate duty on property other than agricultural land is to be levied and collected by the Union, but the proceeds excepting those attributable to the Union Territories, are to be assigned to the States. The estate duty was first levied in India in 1953. Pending Parliamentary legislation, the net proceeds are being provisionally distributed so far in the same ratio as the States' share of the divisible pool of income-tax.

The Commission has suggested one per cent as the share attributable to Union territories; the balance is to be apportioned between immovable property and other property in the ratio of the gross value of all such properties brought into assessment in that year. The sum thus apportioned to immovable property located in each State; the remainder is to be allocated among the States according to population. The sum apportioned to property other than immovable property is to be distributed among States as follows:

TABLE XXXI

State	Percentage recommended
Andhra Pradesh	8·76
Assam	2·53
Bihar	10·86
Bombay	13·52
Kerala	3·79
Madhya Pradesh	7·30
Madras	8·40
Mysore	5·43
Orissa	4·10
Punjab	4·52
Rajasthan	4·47
Uttar Pradesh	17·71
West Bengal	7·37
Jammu and Kashmir	1·24

Tax on Railway Fares. As regards the tax on railway fares, the Commission was of the opinion that the share of a State from the proceeds of a railway fares tax should be as nearly as possible on the basis of the net proceeds of actual passenger travel on railways within its limits. Since correct data on State-wise passenger travel were not available, the Commission has estimated these figures on certain assumptions and apportioned the tax on this basis as follows:

TABLE XXXII

State	Percentage recommended
Andhra Pradesh	8·86
Assam	2·71
Bihar	9·39
Bombay	16·28
Kerala	1·81
Madhya Pradesh	8·31
Madras	6·46
Mysore	4·45
Orissa	1·78
Punjab	8·11
Rajasthan	6·77
Uttar Pradesh	18·76
West Bengal	6·31

The net proceeds of the tax to be thus distributed shall be after deducting ¼ per cent for proceeds attributable to Union territories.

Grants-in-aid. The Commission has not made any change in the grants to the four jute-growing States, viz. West Bengal, Bihar, Assam and Orissa, in lieu of a share of the export duty on jute under Article 273, excepting for an adjustment of the grants to Bihar and West Bengal to take account of the transfer of certain areas from Bihar to West Bengal. The sums prescribed were:

State	Amount
Assam	75.00
Bihar	72.31
Orissa	15.00
West Bengal	152.69

These grants will automatically cease at the end of the financial year 1959-60. To prevent dislocation of the finances of these States when the grants cease, the Commission has made suitable provision in its scheme of devolution but they specify that this should not be construed as giving support to the claim of these States for special compensation.

The Commission has tried to meet the requirements of the States by giving them shares in taxes but for most of them this devolution falls short of their total needs and the deficiency has been made good by grants-in-aid. Such grants recommended are much larger than in the past since the requirements of the States for development were not fully taken into account previously. On the assumption that in the five years ending March 31, 1962, revenue expenditure on development of the States should be on the same scale as in the Second Plan and considering the special circumstances of each State, the Commission has recommended grants without any condition from them as follows:

From Bombay, Madras and Uttar Pradesh, the shares of revenue accruing under the scheme of devolution proposed would enable them to meet their current as well as Plan expenditure, and hence no grants-in-aid were considered necessary for these States.

TABLE XXXIII

(Rupees in crores)

State	1957-58	1958-59	1959-60	1960-61	1961-62	Total
Andhra Pradesh ..	4.00	4.00	4.00	4.00	4.00	20.00
Assam ..	3.75	3.75	3.75	4.50	4.50	20.25
Bihar ..	3.50	3.50	3.50	4.25	4.25	19.00
Kerala ..	1.75	1.75	1.75	1.75	1.75	8.75
Madhya Pradesh ..	3.00	3.00	3.00	3.00	3.00	15.00
Mysore ..	6.00	6.00	6.00	6.00	6.00	16.75
Orissa ..	3.25	3.25	3.25	3.50	3.50	16.75
Punjab ..	2.25	2.25	2.25	2.25	2.25	11.25
Rajasthan ..	2.50	2.50	2.50	2.50	2.50	12.50
West Bengal ..	3.25	3.25	3.25	4.75	4.75	19.25
Jammu and Kashmir ..	3.00	3.00	3.00	3.00	3.00	15.00

The principles recommended for determining grants to States were:

(i) The eligibility of a State to grants-in-aid and the amount of such aid should depend upon its fiscal need in a comprehensive sense. In a Union, in which the Centre and the States co-operate for planned development, grants-in-aid should subserve this end. Priorities and provisions in the Plan itself should determine the fiscal needs for development for the period of the Plan.

(ii) The gap between the ordinary revenue of a State and its normal inescapable expenditure should, as far as possible, be met by sharing taxes. Grants-in-aid should be largely a residuary form of assistance given in the form of general and unconditional grants.

(iii) Grants for broad purposes may also be given. While they last, they should be grants-in-aid of revenues, but the States would be under an obligation to spend the whole amount in furtherance of the broad purposes indicated. Where these purposes are provided for in a comprehensive plan, there will be no scope for such grants.

Union Loans to States. In recent years, there has been a phenomenal growth in the number and amount of loans

given by the Government of India to the States; the outstanding amount of such loans increased from Rs. 43·97 crores on August 15, 1947 to Rs. 195·41 crores on March 31, 1951 and to about Rs. 900 crores on March 31, 1956. The terms of repayment and the rates of interest vary widely among the loans. The rates of interest have varied from 1 to 5 per cent, some loans being free from interest, and have generally been determined with reference to the redemption yield of Central loans of a corresponding maturity period except when special concessional rates have been given. The large number of loans given and the wide variations in the rates of interest and the terms of repayment have introduced unavoidable complications in the financial relations between the Centre and the States.

In respect of loans which are given interest-free the Commission has recommended that no modifications need be made. But they feel that the policy of giving loans interest-free or at concessional rates of interest is open to subjection since such a concession conveys a wrong impression regarding the interest burden which has to be met and also because such concessions are not subject to Parliamentary control as no funds are voted to cover them. In the case of loans given for the rehabilitation of displaced persons, they have recommended that with effect from April 1, 1957, the State Governments should be required to pay to the Centre only the sums realised by them from the displaced persons on account of principal and interest, including arrears outstanding on that date. Regarding the remaining loans they are of the opinion that the reasonable rate to be charged to the States by the Union should be 3 per cent and this rate should apply to all loans, irrespective of the period of maturity. They have recommended that the outstanding balances of loans carrying interest at 3 per cent and above should be consolidated for each State at 3 per cent. For purposes of repayment, they should be split up into two categories: (*a*) the loans due to be repaid within a period of twenty years from April 1, 1957 should be consolidated into one single loan repayable after twenty years from that date, should be consolidated into another single loan repayable at the end of thirty years. They have suggested a similar

consolidation of loans carrying interest at less than 3 per cent into two loans but carrying an average rate of interest of 2½ per cent. It is expected that the suggested scheme of consolidation will result in a reduction in interest charges of about Rs. 5 crores per annum for all the States together. The Commission has also suggested that though the above recommendations apply only to the loans given between August 15, 1947 and March 31, 1956, they may be adopted for future years also. This will mean that each State will get only two loans a year (one medium-term and one long-term), at rate of interest approximating to the net cost of all Union borrowings in that period. In that case, it is suggested, that during the course of a financial year no regular loans but only ways and means advances be given which may be converted into two regular loans as indicated above at the end of the year.[1]

[1] The recommendations regarding loans have been implemented by executive orders. As for the repayment of loans by the States to the Centre, the Commission's scheme of consolidation of loans postponing the date of implementation would have the effect of postponing the repayment of loans normally due during the next 15 years. Consequently, there would be a reduction in the resources available for the Centre to assist the State Governments by way of fresh loans either for Plan projects or for projects outside the Plan. The Government has, however, conceded that the scheme of consolidation should be left for discussion with individual State Governments. The suggestion of the Commission for the fixation of a uniform rate of interest for all States irrespective of purposes for which loans were taken, was also not accepted by the Government. The Government has instead laid down the following basis for calculation of interest rates on loans granted to States which would take effect from April 1, 1958, and would apply to all loans outstanding against the States on March 31, 1958 other than those sanctioned prior to August 15, 1947: (1) The rate of interest on loans for industrial and commercial enterprises and industrial housing should remain unchanged, (2) The rate of interest on loans for electricity undertakings and extension of power facilities should be refixed at 4 per cent, (3) The loans for multipurpose river-valley projects should be split into two — one for power and the other for irrigation and other purposes. The former should bear interest at 4 per cent and the latter at 3 per cent an *ad hoc* rate being settled where such a break is not possible, in consultation with the State Government concerned and the Planning Commission, (4) The rate of interest on other loans except those for rehabilitation of displaced persons and interest-free loans should be refixed at 3 per cent except that, where the rate now applicable is less than 3 per cent the lower rate shall continue to apply. As for loans for rehabilitation purposes the Government has accepted the Commission's recommendation that the States should pay to the Union Government with effect from April 1, 1947 only the amounts of principal and interest they collect on account of these loans, including the arrears, if any, outstanding on that date. The net effect of these changes would be to reduce by Rs. 4 crores per annum (as against Rs. 5 crores estimated by the Commission) the interest burden of States on account of loans taken between August 15, 1947 and March 31, 1958.

Net Effect

The recommendations of the Commission provide for a devolution of about Rs. 140 crores (not including the proceeds of the tax on railway fares amounting to Rs. 15 crores in a full year) a year as against an average sum of Rs. 93 crores received by the States under the first Finance Commission's recommendations in the five years ending March 31, 1957. An integrated scheme of devolution is proposed, taking into account the needs of the States with due regard to the ability of the Union with its responsibilities for defence and national development, to transfer resources to the States. In the recommended scheme a balance is maintained between devolution by transfer of shares of taxes and distribution by fixed

TABLE XXXIV

(Rupees in crores)

State	Shares of Taxes	Grant under Article 273[1]	Grant under substantive portion of Article 275(I)	Total	Tax on Railway fares
Andhra Pradesh ..	8.50	..	4.00	12.50	1.31
Assam ..	2.75	0.45	4.05	7.25	0.40
Bihar ..	10.00	0.43	3.80	14.23	1.39
Bombay ..	14.75	..	..	14.75	2.41
Kerala ..	3.75	..	1.75	5.50	0.27
Madhya Pradesh ..	7.00	..	3.00	10.00	1.23
Madras ..	8.25	..	..	8.25	0.96
Mysore ..	5.50	..	6.00	11.50	0.66
Orissa ..	4.00	0.09	3.35	7.44	0.26
Punjab ..	4.25	..	2.25	6.50	1.20
Rajasthan ..	4.25	..	2.50	6.75	1.00
Uttar Pradesh ..	16.25	..	..	16.25	2.78
West Bengal ..	9.50	0.91	3.85	14.26	0.94
Jammu and Kashmir	1.25	..	3.00	4.25	..
	100.00	1.88[1]	37.55	139.43	14.81

[1] This is an average for five years of payments which will actually be made to the States in the three years ending March 31, 1960. Grants-in-aid under Article 273 cease on the expiry of ten years from the commencement of the Constitution.

grants-in-aids. The table below summarizes what each State may expect to receive under the recommendations taken together in each of the five years beginning on April 1, 1957. The figures shown against shares of taxes are only estimates and indicated the order of the sums to be received; the actuals will vary from year to year.

IX

BUDGETARY POSITION

In the previous chapters we have discussed the tax structure under the Constitution; the distribution of revenues between the Union and the States and the payment of grants-in-aid by the Union Government. We now attempt a brief survey of the trends in revenues of the Government of India and the States. The task is full of difficulties. It is impossible to compare the present revenues of the States with their past budgetary position on account of the partition of the country in 1947; the merger of the former princely States with the Provinces; the amalgamation of some other States with Part B and C States followed by the financial integration of Part B States with the Indian Union from April 1, 1950; and the reorganisation of the States with effect from November 1, 1956. The comparison of the data becomes even more difficult as we go backwards owing to (1) the separation of Burma in 1937; (2) the changes in the constitutional basis of financial relations between the Centre and the Provinces/States in 1919, 1935 and 1949; and (3) the changes in areas of the Provinces (e.g. Sind was separated from Bombay and a separate province of Orissa was created in 1935).

It is, therefore, necessary to keep these changes in view when making a comparative study of the trends in public revenues during the past few decades.

The plan of this chapter is as follows: First an account of the revenues of the Government of India will be given; this will be followed by an analysis of the revenues of the Provinces and Part A States. The financial position of Part B and C States for the period for which they existed will also be briefly stated. Finally, the principal changes in comparative importance of the tax revenues of the Union and the States will be examined.

§ 1. *FINANCIAL POSITION OF THE GOVT. OF INDIA*

Revenue Account

It is possible to obtain a general idea of the financial position of the Government of India and of the changes in its

TABLE XXXV

INDIA'S PUBLIC REVENUE AND EXPENDITURE

(In crores of rupees)

	REVENUE				EXPENDITURE				
Year	Revenue	Tax Revenue	(2) as percentage of (1)	Non-tax Revenue	Expenditure	Defence on Revenue Account (Net)	(2) as percentage of (1)	Civil Expenditure	C—Surplus (+) or Deficit (—)
1938-39	84.47	73.90	87.5	10.57	85.11	46.18	54.3	38.93	— 0.64
1939-40	94.57	80.67	85.3	13.90	94.57	49.54	52.4	45.03	—
1940-41	107.65	77.14	71.7	30.51	114.18	73.61	64.5	40.57	— 6.53
1941-42	134.56	97.92	72.8	36.65	147.26	103.93	70.6	43.33	— 12.70
1942-43	177.09	124.89	70.5	52.20	288.87	214.62	74.3	74.25	—111.78
1943-44	249.96	171.15	68.5	78.80	439.86	358.40	81.5	81.46	—189.90
1944-45	335.70	253.90	75.6	81.81	496.25	395.49	79.7	100.76	—160.55
1945-46	361.19	282.14	78.1	79.05	484.61	360.23	74.3	124.38	—123.43
1946-47[1]	342.89	274.46	80.0	68.43	343.49	207.37	60.4	136.12	— 0.60
1947-48[2]	178.77	162.05	90.7	16.72	185.29	86.63	46.8	98.66	— 6.52
1948-49	371.70	319.94	86.1	51.76	320.86	146.05	45.5	174.81	— 50.84
1949-50	350.39	311.54	88.9	38.85	317.12	148.86	46.9	168.26	33.27
1950-51	410.66	357.00	86.9	53.66	351.44	164.13	46.7	187.31	59.22
1951-52	515.36	459.99	89.3	55.37	387.27	170.96	44.1	216.31	128.09
1952-53	435.11	387.06	89.0	48.05	396.18	179.52	47.3	216.66	38.93
1953-54	415.98	363.28	87.3	52.70	407.48	186.30	45.7	221.18	8.50
1954-55	456.13	399.26	87.5	56.87	422.62	186.66	44.2	235.96	33.51
1955-56	504.32	428.04	84.9	76.28	463.87	172.23	37.1	291.64	40.45
1956-57	589.96	493.76	83.7	96.20	500.56	192.15	38.3	308.41	89.40
1957-58[3]	724.63	557.60	76.9	167.03	719.53	266.05	36.7	453.53	5.05
1958-59[4]	768.99	572.34	74.5	196.65	796.01	278.14	34.9	517.87	— 27.02

[1] Figures up to and including 1946-47 relate to undivided India and later figures relate to the Indian Union.
[2] From August 15, 1947 to March 31, 1948.
[3] Figures for 1957-58 are Revised estimates.
[4] Figures for 1958-59 are Budget proposals.

budgetary position by comparing the overall position of its revenue and expenditure since 1938-39. Table XXXV gives the total revenue, the tax revenue, the total expenditure, expenditure on defence account, the civil expenditure and the surplus or deficit on revenue account since 1938-39.

No direct comparison can be made between the account of the Government of India before 1946-47 with those of the later years as the earlier figures relate to undivided India. However, to illustrate the general trend of financial development the earlier figures are of great significance. (The revenue of the Government of India has increased from Rs. 84.47 crores in 1938-39 to Rs. 768.99 crores in 1958-59 (including budget proposals). The growth of revenue in some of the years is as follows:

TABLE XXXVI

(In crores of rupees)

Years	Revenue	
1938-39	84.47	
1948-49	371.70	
1949-50	350.39	
1950-51	410.66	
1951-52	515.36	
1952-53	435.11	
1953-54	415.98	
1954-55	456.13	
1955-56	505.32	
1956-57	589.96	
1957-58	724.63	(Revised estimates)
1958-59	768.99	(Includes Budget proposals)

From the above figures it would appear that the revenue of the Government of India increased from Rs. 84.47 crores in 1938-39 to 768.99 crores in 1958-59. The growth in revenue, however, does not give a correct picture of the financial position unless the growing expenditure during the period is taken into account. The corresponding expenditure and surplus or deficit during the above years is as follows:

TABLE XXXVII

(In crores of rupees)

Years			Expenditure	Surplus or Deficit —
1938-39	..	..	85.11	— 0.64
1948-49	..	..	320.86	50.84
1949-50	..	..	317.12	33.27
1950-51	..	..	351.44	59.22
1951-52	..	..	387.22	128.09
1952-53	..	..	396.18	38.93
1953-54	..	..	407.48	8.50
1954-55	..	..	422.62	33.51
1955-56	..	..	463.87	41.45
1956-57	..	..	500.56	89.40
1957-58	..	..	719.58	5.05
1958-59	..	..	796.01	— 27.02

The budgets of the Government of India during the period 1938-1958 are sharply divided into two periods: (1) 1938-39 to 1947-48 and (2) 1948-49 to 1957-58. The period 1938-39 to 1947-48 was one of deficits; the period 1948-49 to 1958-59 has been one of uninterrupted surplus; the total surplus during 1948-58 was Rs. 488.26 crores.

Capital Account

However, the above revenue account of the Government of India does not give a complete picture of the financial position unless we take into consideration the capital account of the Government. The following table gives the surplus deficit in the capital account during the period 1938-39 to 1957-58:

TABLE XXXVIII

(In crores of rupees)

Year			Surplus Deficit (—)
1938-39	..	..	8.05
1939-40	..	..	3.22

TABLE XXXVIII (*Continued*)

Years			Surplus or Deficit —	
1940-41	..	..	37.39	
1941-42	..	..	— 25.44	
1942-43	..	..	144.18	
1943-44	..	..	199.54	
1944-45	..	..	437.51	
1945-46	..	..	405.11	
1946-47	..	..	— 56.99	
1947-48	..	..	—133.41	
1948-49	..	..	—167.48	
1949-50	..	..	— 80.05	
1950-51	..	..	— 62.04	
1951-52	..	..	—124.39	
1952-53	..	..	— 94.24	
1953-54	..	..	— 69.84	
1954-55	..	..	— 52.20	
1955-56	..	..	— 66.59	
1956-57	..	..	8.64	(Revised estimates)
1957-58	..	..	— 43.78	(Budget proposals)

The above table is significant in pointing out that there were huge surpluses in capital account during the years 1942-43, 1943-44, 1944-45, and 1945-46, amounting to Rs. 144.18 crores, Rs. 199.54 crores, Rs. 437.51 crores and Rs. 405.11 crores respectively (these were years of deficits in revenue account). A period of deficits started in 1946-47 and has continued since then; the deficit during 1951-52, 1952-53, 1953-54, 1954-55, 1955-56 being Rs. 124.39 crores Rs. 94.24 crores, Rs. 69.84 crores Rs. 52.20 crores; Rs. 66.59 crores respectively—the total deficit during the period 1951-56 was Rs. 407.26 crores. The inevitable conclusion is that the surpluses in revenue account have helped to finance a part of capital expenditure. But as the deficits on capital account have been consistently large, there has been a depletion in the cash balances of the Government of India. The overall surplus or deficit position during the period is as follows:

TABLE XXXIX

(In crores of rupees)

Year	Surplus or Deficit (—)
1938-39	1.83
1939-40	3.48
1940-41	— 1.94
1941-42	1.29
1942-43	2.29
1943-44	65.43
1944-45	182.62
1945-46	263.25
1946-47	—111.58
1947-48	—110.68
1948-49	— 81.67
1949-50	— 43.80
1950-51	12.44
1951-52	0.91
1952-53	— 63.54
1953-54	— 61.29
1954-55	— 5.48
1955-56	— 36.49
1956-57	54.38
1957-58	— 0.08

The cash balances of the Government of India have also been reduced from Rs. 270.30 crores immediately after the partition of the country to Rs. 158.68 crores at the end of March, 1952. The opening and closing balances of the Government of India since 1938-39 are given in the following table:

TABLE XL

(In crores of rupees)

Year	Opening balance	Closing balance
1938-39	11.31	13.14
1939-40	13.14	16.62
1940-41	16.62	14.68

TABLE XL (*Continued*)

Year			Opening balance	Closing balance
1941-42	..	..	14.68	15.94
1942-43	..	..	15.94	18.23
1943-44	..	..	18.23	83.66
1944-45	..	..	83.66	266.28
1945-46	..	..	226.28	417.95
1946-47	..	..	529.53	559.53
1947-48	..	..	270.30	159.62
1948-49	..	..	273.90	192.23
1949-50	..	..	193.28	149.48
1950-51	..	..	149.50	161.94
1951-52	..	..	161.78	162.69
1952-53	..	..	162.68	99.14
1953-54	..	..	99.14	37.85
1954-55	..	..	37.85	32.01
1955-56	..	..	32.23	4.26
1956-57	..	..	4.26	50.12
1957-58	..	..	50.12	50.04

Trends in Budgetary Position

After this broad picture of the trends in the revenue position during the period 1938-58 we pass on to analyse in greater detail the trends in budgetary position during the period 1951-52 to 1956-57.

(The accounts for 1951-52 revealed a revenue surplus of Rs. 128 crores or an increase of Rs. 35 crores over the surplus in the revised estimates for that year. This was due to an increase of Rs. 18 crores in revenue to Rs. 515 crores and an equal fall in expenditure of Rs. 387 crores. The increase in receipts was mainly under income and corporation taxes. On the expenditure side, the fall was due in large measure to a reduction in defence outlay, the actual expenditure amounting to only Rs. 171 crores, as against Rs. 181 crores in the revised estimates.)

The accounts for 1952-53 showed a revenue surplus of Rs. 39 crores as against an anticipated deficit of Rs. 4 crores in the revised estimates for that year. This substantial improvement was due to an increase of Rs. 17 crores in revenue to Rs. 435 crores and a decline of Rs. 26 crores in expenditure

of Rs. 396 crores. The improvement in revenue was due mainly to larger receipts under income and corporation taxes and Union excise duties. The fall in expenditure was mostly in defence, civil administration, miscellaneous expenditure and assistance to States.

The actual position in 1953-54 was different from that as envisaged in the revised estimates, since there was a revenue surplus of Rs. 8.5 crores instead of a deficit of Rs. 17 crores. This improvement was due to a decline (mostly under defence and civil administrations) of Rs. 24 crores in expenditure and an improvement of Rs. 2 crores in revenue.

The final outturn for 1954-55 proved to be a surplus of Rs. 33.5 crores as against a deficit of Rs. 5 crores anticipated in the revised estimates; while revenue improved by Rs. 5 crores, expenditure was lower by Rs. 33 crores, the reduction in expenditure being largely under defence (Rs. 11.4 crores) and developmental services (Rs. 9.1 crores).

The accounts for 1955-56 showed a much larger surplus of Rs. 40.5 crores as compared to the surplus of Rs. 12.3 crores in the revised estimates; revenue increased by Rs. 3 crores while expenditure was lower by Rs. 25 crores, the decline in expenditure being mainly under development services (Rs. 15 crores) and defence (Rs. 13 crores).

The revised estimates for 1956-57 revealed a surplus of Rs. 37.9 crores as against the budgeted deficit of Rs. 18 crores, the improvement being due to an increase in the revenue of Rs. 44 crores and a reduction in expenditure of Rs. 12 crores. The improved revenue position was largely due to better collections under customs and Union excise duties, the increase in the latter representing, in the main, the yield of the additional duty on cotton cloth imposed during the year.

Trends in Tax Revenues

The tax revenues of the Government of India are mainly derived from three heads:—Taxes on incomes (21.5 per cent); Customs (25.2 per cent); and Central excise duties (36.6 per cent), which together accounted for 83.3 per cent of the revenues in 1957-58. Of the total tax revenue of the Government of India of Rs. 494.76 (revised) in 1956-57, (not deducting

the shares payable to States) income tax, customs, and excise duties accounted for Rs. 131 crores, Rs. 171 crores and Rs. 189 crores respectively. The total yield from income-tax is more than ten times the pre-war level. Taxes on income formed 22 per cent of the total Central tax-revenue collection (including tax shares of the Provinces) in 1938-39. This proportion rose as high as 68 per cent in 1944-45, but was reduced in the post-war period to 45 per cent in 1949-50 and is now about 40 per cent. The yield from estate duty is comparatively very small; it was Rs. 0.81 crores, Rs. 1.81 crores, Rs. 2.52 crores, Rs. 2.52 crores and Rs. 3.0 crores during 1954-55, 1955-56, 1956-57 and 1957-58 and 1958-59 respectively.

The yield from wealth tax was Rs. 9 crores in 1957-58 (revised). It is expected to yield Rs. 12.5 crores in 1958-59 (Budget). The expenditure tax and the proposed Gift tax are expected to yield Rs. 3 crores each in the 1958-59 (Budget).

The Customs duty was till 1955-56 the largest single source of revenue (Rs. 166.70 crores) of the Government of India. In 1956-57 it became the second important source of revenue (Rs. 150 crores). The major portion of the yield from import duties is derived from revenue duties and only a small amount (about Rs. 6 crores) from protective duties. Export duties which were unimportant before the War expanded considerably during the War period and particularly after the devaluation of the rupee and the outbreak of the Korean war. They have been levied for two purposes: (i) revenue duties on monopoly exports and exports in short supply; (ii) and as flexible inflationary tax measures during a period of huge export profits. The yield from export duties rose from Rs. 4 crores in 1938-39 to the peak figure of Rs. 90.74 crores in 1951-52 (when the total customs revenue reached the highest figure of Rs. 231.78 crores). The yield from export duties was Rs. 27.70 crores and Rs. 28.70 crores in 1956-57 and 1957-58 (estimated). Broadly speaking, it may be said that the proportion of custom revenues in the budget of the Government of India increased from about two-fifths at the beginning of the inter-war period (1921-22) to about one-half in 1938-39; it now stands at about two-fifths of the Central revenues.[1]

[1] For details *see* Ch. XVII.

The Central excise duties now occupy the most important place in the Union tax structure. The yield from them rose gradually from less than Rs. 3 crores in 1921-22 to over Rs. 13 crores in 1936-37. In 1938-39 the yield from the duties was less than Rs. 9 crores. In 1951-52, 1952-53, 1953-54, 1954-55, 1955-56, 1956-57, and 1957-58 their yield has been Rs. 85.78 crores, Rs. 94.98 crores, Rs. 108.22 crores, Rs. 145.25 crores, Rs. 190.43 crores, and Rs. 264.55 (revised) respectively.[1]

§2. *STATE BUDGETS*

FINANCES OF PART A STATES

In this section an attempt will be made to analyse the finances of the States during the period 1939-57. The finances of Part A States will be described in the beginning followed by an account of the finances of Part B and C States. It may be pointed out that no account is available of the budgets of Part B and C States prior to 1949-50 and hence no comparison in their budgetary position with the pre-war year 1938-39 is possible.

Trends in Revenue and Expenditure

Table XL shows the consolidated budgetary position of Part A States regarding their revenue, expenditure and surplus or deficit since 1938-39:

It will appear from the above table that the revenues of Part A States increased from Rs. 84.74 crores in 1938-39 to Rs. 426.1 crores in 1956-57. The expenditure has similarly increased from Rs. 85.76 crores in 1938-39 to Rs. 488.9 crores in 1956-57. It is significant to point out that an era of surplus started since 1939-40 and continued till 1951-52. There has not been a single year of deficit all through this period. (The State budgets stand in contrast with the Central budgets during the period 1939-40 to 1947-48 which were years of heavy deficits in the Government of India's finances.) The debt of all Part A States increased from Rs. 163.20 crores in 1938-39 to Rs. 330.12 crores in 1951-52.

[1] For details *see* Ch. XVI.

TABLE XLI

(In crores of rupees)

Year		Part A States	
	(1) Revenue	(2) Expenditure met from Revenue	(3) Surplus (+) or Deficit (—)
1938-39 ..	84.74	85.76	— 1.02
1939-40 ..	90.83	89.22	1.61
1940-41 ..	97.48	95.18	2.30
1941-42 ..	107.41	103.48	3.93
1942-43 ..	124.31	118.18	6.13
1943-44 ..	163.31	153.85	9.46
1944-45 ..	208.18	204.28	3.90
1945-46 ..	229.33	218.14	11.19
1946-47 ..	238.80	230.09	8.71
1947-48 ..	202.77	194.19	8.58
1948-49 ..	258.21	250.82	7.39
1949-50 ..	291.31	287.29	4.02
1950-51 ..	294.32	293.14	1.18
1951-52 ..	304.8	298.3	6.5
1952-53 ..	318.2	318.3	— 0.1
1953-54 ..	347.0	347.0	— 0.1
1954-55 ..	368.1	368.1	— 15.9
1955-56 ..	420.8	420.8	— 50.6
1956-57 ..	426.1	426.1	— 62.8

The major heads of tax revenue of the States are (1) Taxes on Income, (2) Land Revenue (3) Sales Tax (4) Excise and (5) Stamps. An analysis of the distribution of tax revenue of some of the heads is necessary for a broad picture of the trends of State finances during the period 1938-39 to 1957-58.

(In crores of rupees)

	1938-39	1948-49	1949-50	1950-51	1951-52
Taxes on Income ..	1.50	41.79	45.74	46.97	52.31
Land Revenue ..	25.41	25.78	29.06	33.21	33.91
Sales Tax ..	..	32.95	46.30	51.34	47.74
Excise ..	13.08	34.32	29.03	27.04	26.28
Stamps ..	9.59	16.31	17.32	19.22	20.19

The preceding table is interesting in pointing out the remarkable change in the distribution of tax revenue in State finances since 1938-39. The States' share of income-tax increased from Rs. 1.50 crores in 1938-39 to Rs. 52.31 crores in 1951-52; it now forms the largest single source of State revenues. The receipts from land revenue have increased from Rs. 25.41 crores to Rs. 33.91 crores. Perhaps the most remarkable change in the States' finances has been the phenomenal growth of revenue from sales tax which did not exist at all as a source of State revenue in 1938-39. The revenue from sales tax reached the peak point of Rs. 51.34 crores in 1950-51. The revenue from excise increased from Rs. 13.08 crores in 1938-39 to Rs. 26.28 crores in 1952-53. Finally, the receipts from stamps increased from Rs. 9.59 crores in 1938-39 to Rs. 20.19 crores in 1951-52.

Since 1951-52, the distribution of revenues has been grouped under certain broad heads and the results are given in Table XLI.

From the above table it appears that the States' share of income-tax, agricultural income-tax and professional tax contributed 12.08 per cent; estate duty, land revenue, stamps and registration and urban immovable property tax 22.76 per cent; and excise duties, sales tax, entertainment tax, electricity duties, motor vehicles tax, sugar-cane, tobacco duties, 32.4 per cent to total revenues in 1956-57. The percentages of tax revenue and non-tax revenue to the total revenue are 66.98 per cent and 33.02 per cent respectively.

Having briefly surveyed the budgetary position of Part A States during 1938-39 to 1956-57, we give below a somewhat detailed account of their budgets during the period 1951-52 to 1956-57. The improvement in the revenue account position in 1951-52 over the previous year was due to the fact that while the total revenue rose by Rs. 21 crores, total expenditure had increased by only 16 crores. With the exception of Madras, which had a heavy deficit of Rs. 5 crores, all the States had revenue surpluses, that of Madhya Pradesh at Rs. 5.4 crores being the largest. Bihar's surplus of Rs. 1.5 crores was, however, due to a transfer of Rs. 6 crores from the Revenue Reserve Fund to revenue account.

TABLE XLII

		Taxes on Income (*a*)	Taxes on Property and Capital Transactions(*b*)	Taxes on Commodities and Services (*c*)	Total Tax Revenue	Non-Tax Revenue (*d*)	Total Expenditure (*e*)	Surplus (+) or Deficit (−) (*f*)
	1	2	3	4	5	6	7	8
1951-52	55,62	56,67	1,07,03	2,19,32	85,48	3,04,80	2,98,31	— 6,49
1952-53	54,21	61,97	1,15,58	2,31,76	86,39	3,18,15	3,18,29	— 14
1953-54	53,32	74,95	1,25,75	2,54,52	92,48	3,47,00	3,47,08	— 8
1954-55	52,74	75,22	1,30,33	2,58,27	1,09,85	3,68,12	3,84,04	—15,92
1955-56	53,00	84,89	1,34,77	2,72,66	1,48,15	4,20,81	4,71,37	—50,56
1956-57	51,46	96,97	1,36,94	2,35,37	1,40,71	4,26,08	4,88,93	—62,85

Note—Figures given here would differ from those in the Budget papers as certain adjustments have been made to ensure uniformity in presentation. As accounts figures for Madras (Composite State) for 1953-54 are not available Budget figures are used in the Statement.

(*a*) Includes, (i) States' share of income-tax, (ii) agricultural income-tax and (iii) profession tax.

(*b*) Covers estate duty, land revenue, stamps and registration and urban immovable property tax

(*c*) Comprises excise duties, sales tax, entertainment tax, electricity duties, motor vehicles tax, sugar-cane cess, tobacco duties, taxes on prize competitions, raw jute, etc.

(*d*) Includes administrative receipts, net contribution of public enterprises, grants-in-aid and other contributions from the Centre, etc.

(*e*) Figures from 1955-56 are Revised estimates.

(*f*) Budget estimates for 1956-57.

The consolidated account for 1952-53 disclosed a deficit of Rs. 0.1 crores as against a deficit of Rs. 3.1 crores envisaged in the revised estimates. The improvement was due to a sizeable reduction in expenditure (Rs. 11 crores) mostly on developmental heads, which was, however, partially neutralised by a fall (Rs. 8 crores) in revenue spread over both tax and non-tax heads. The deficit increased in Madras (Rs. 10 crores), Bombay (Rs. 6 crores) and West Bengal (Rs. 1 crore). The U.P. had a balanced account and the remaining States had surpluses of varying magnitude.

As at the Centre, the outturn for 1953-54 showed considerable

improvement over the revised estimates; there was only a nominal deficit of Rs. 8 lakhs as compared to an anticipated deficit of Rs. 14 crores owing mainly to a short-fall in development expenditure.

The year 1954-55 closed with a deficit of Rs. 16 crores as against an anticipated deficit of Rs. 27 crores in the revised estimates. Revenue was lower by Rs. 8 crores and expenditure by Rs. 19 crores.

The interim budget estimates of the States for 1957-58 placed revenue at Rs. 639 crores and expenditure at Rs. 730 crores, thus showing a revenue deficit of Rs. 91 crores. These may be compared with a revenue of Rs. 596 crores, an expenditure Rs. 673 crores and a deficit of Rs. 77 crores in the budget estimates for 1956-57. All the State budgets showed revenue deficits for 1957-58. The consolidated budgetary position of all Part A State on revenue account during the period 1951-52 to 1956-57 is given in the following table:

TABLE XLIII

BUDGETARY POSITION OF PART A STATES

1. Figures in columns 1 to 5 are in percentages.
2. Figures for columns 6, 7 & 8 are in Lakhs of Rupees.
3. Figures in columns 4 and 5 are percentages of Total Revenue as stated in column 6.

STATES	Taxes on Income (a)	Taxes on Property and Capital Transactions (b)	Taxes on Commodities and Services (c)	Total Tax Revenue	Non-Tax Revenue (d)	Total Revenue	Total Expenditure (e)	Surplus (+) or Deficit (—) (f)
	1	2	3	4	5	6	7	8
Assam								
1951-52 ..	23.22	19.89	24.61	67.72	32.28	1081	10,45	36
1952-53 ..	18.05	17.25	22.82	58.12	41.88	1385	12,15	1,70
1953-54 ..	17.05	16.33	23.31	56.69	43.31	1390	13,31	59
1954-55 ..	14.32	14.00	27.88	56.20	43.80	1571	18,69	— 2,98
1955-56 ..	12.87	12.54	27.33	52.74	47.26	2082	21,80	— 98
1956-57 ..	12.20	13.24	28.41	53.85	46.15	2115	24,80	— 3,65

TABLE XLIII (*Continued*)

STATES		Taxes on Income (*a*)	Taxes on Property and Capital Transactions (*b*)	Taxes on Commodities and Services (*c*)	Total Tax Revenue	Non-tax Revenue (*d*)	Total Revenue	Total Expenditure (*e*)	Surplus (+) or Deficit (—) (*f*)
		1	2	3	4	5	6	7	8
Bihar									
1951-52	..	21.01	12.49	33.12	66.62	33.38	3379	32,31	1,48
1952-53	..	18.07	14.79	35.96	68.82	31.18	3570	27,73	7,97
1953-54	..	19.45	18.78	37.44	75.67	24.33	3317	31,10	2,07
1954-55	..	17.09	17.96	34.17	69.22	30.78	3535	41,48	— 6,13
1955-56	..	15.01	22.35	32.49	69.85	30.15	3924	59,42	—20,18
1956-57	..	13.18	26.50	29.90	69.58	30.42	4287	63,75	—20,88
Bombay									
1951-52	..	17.86	19.70	34.90	72.46	27.54	6152	61,40	12
1952-53	..	17.44	19.29	36.28	73.01	26.99	6118	67,12	— 5,94
1953-54	..	15.15	17.05	38.69	70.89	29.11	7103	69,88	1,15
1954-55	..	13.32	17.24	42.92	73.48	26.52	7801	70,08	7,93
1955-56	..	13.10	17.95	42.94	73.99	26.01	7816	77,33	83
1956-57	..	12.98	18.21	41.85	73.04	26.96	7634	76,11	23
Madhya Pradesh									
1951-52	..	14.18	25.42	27.21	66.81	33.19	2242	17.04	5,38
1952-53	..	14.07	28.15	30.63	72.85	27.15	2295	18,30	4,65
1953-54	..	13.53	27.19	28.39	69.11	30.89	2402	23,77	25
1954-55	..	11.61	22.59	26.01	60.21	39.79	2722	27.76	— 54
1955-56	..	9.05	18.71	20.74	48.50	51.50	3437	33,76	61
1956-57	..	10.31	25.02	26.97	62.30	37.70	2918	33,00	— 3,82
Madras									
1951-52	..	15.75	21.02	40.51	77.28	22.72	5809	63,10	— 5,01
1952-53	..	16.51	20.21	43.19	79.91	20.09	5705	67,03	— 9,98
1953-54	..	13.90	21.56	40.95	76.41	23.59	6438	64,38	..
1954-55	..	13.39	17.76	39.48	70.63	29.37	4235	46,27	— 3,92
1955-56	..	12.28	20.59	34.13	67.00	33.00	5163	53,84	— 2,21
1956-57	..	11.44	23.57	30.87	65.88	34.12	5953	61,19	— 1,66
Andhra									
1954-55	..	16.88	34.18	33.14	84.20	15.80	1931	24,49	— 5,18
1955-56	..	14.68	25.34	31.66	71.68	28.32	2186	25,83	— 3,97
1956-57	..	13.46	27.26	32.50	73.22	26.78	2311	26,36	— 3,25

TABLE XLIII (*Continued*)

STATES		Taxes on Income (*a*)	Taxes on Property and Capital transactions (*b*)	Taxes on Commodities and Services (*c*)	Total Tax Revenue	Non-Tax Revenue (*d*)	Total Revenue	Total Expenditure (*e*)	Surplus (+) or Deficit (−) (*f*)
		1	2	3	4	5	6	7	8
Orissa									
1951-52	..	14.60	14.09	31.27	59.96	40.04	1164	10,54	1,10
1952-53	..	17.48	14.79	34.31	66.58	33 42	1224	11,14	1,10
1953-54	..	18.00	18.08	34.23	70.31	29.69	1189	12.83	— 94
1954-55	..	15.56	14.09	31.19	60.84	39.16	1356	15,05	— 1,49
1955-56	..	11.47	12.45	21.07	44.99	55.01	1927	26,15	— 6,88
1956-57	..	10.80	14.05	22.66	47.51	52.48	1871	24,32	— 5,61
Punjab									
1951-52	..	16.79	17.38	30.02	64.19	35.81	1709	15,37	1,72
1952-53	..	11.74	16.98	31.28	60.00	40.00	1755	15,71	1,84
1953-54	..	10.53	16.40	32.18	59.11	40.89	1976	18,90	86
1954-55	..	8.84	15.58	32.34	56.76	43.24	2183	19,55	2,28
1955-56	..	7.10	12.41	27.20	46.71	53.29	2676	29,45	— 2,69
1956-57	..	6.40	14.46	26.25	47.11	52.89	2876	29,23	— 47
Uttar Pradesh									
1951-52	..	20.28	19.83	31.39	71.50	28.50	5139	51,33	6
1952-53	..	16.91	23.67	30.63	71.21	28.79	6072	60,72	— .
1953-54	..	14.26	32.48	30.88	77.62	22.38	7139	68,56	2,83
1954-55	..	13.69	31.51	28.64	73.84	26.16	7282	72,21	6
1955-56	..	12.47	30.73	26.28	69.48	30.52	7903	79,03	—
1956-57	..	12.18	32.59	25.84	70.61	29.39	7797	87,52	— 9,55
West Bengal									
1951-52	..	20.24	14.37	45.15	79.76	20.24	3805	36,77	1,28
1952-53	..	20.24	14.49	47.20	81.93	18.07	3691	38,39	— 1,48
1953-54	..	20.40	14.28	45.27	79.95	20.05	3746	44,35	— 6,89
1954-55	..	18.93	11.20	42.99	73.12	26.88	4196	48,46	— 6,50
1955-56	..	15.24	13.83	38.23	67.30	32.70	4967	64,76	—15,09
1956-57	..	14.51	18.74	42.22	75.47	24.53	4846	62,65	—14,19

Note.—Figures given here would differ from those in the Budget papers as certain adjustments have been made to ensure uniformity in presentation. As account figures for Madras (Composite State) for 1953-54 are not available Budget figures are used in the Statement.

(*a*) Includes, (i) States' share of income-tax, (ii) agricultural income-tax and (iii) profession tax.
(*b*) Covers estate duty, land revenue, stamps and registration and urban immovable property tax.
(*c*) Comprises excise duties, sales tax, entertainment tax, electricity duties, motor vehicles tax, sugarcane cess, tobacco duties, taxes on prize competitions, raw jute, etc.
(*d*) Includes administrative receipts, net contribution of public enterprises, grants-in-aid and other contributions from the Centre, etc.
(*e*) Figures for 1955-56 are Revised Estimates.
(*f*) Budget Estimates for 1956-57.

The overall consolidated budgetary position of all the Part A States is given in Table XLIV.

TABLE XLIV*

1. Figures in columns 1 to 5 are in percentages.
2. Figures in columns 6, 7 and 8 are in lakhs of rupees.
3. Figures in columns 4 and 5 are percentages of Total Revenue as stated in column 6.

	Taxes on Income	Taxes on Property and Capital transactions	Taxes on Commodities and Services	Total Tax Revenue	Non-Tax Revenue	Total Revenue	Total Expenditure	Surplus (+) or Deficit (−)
	1	2	3	4	5	6	7	8
1951-52	18.25	18.59	35.12	71.96	28.04	30480	2,98,31	— 6,49
1952-53	17.04	19.48	36.33	72.85	27.15	31815	3,18,29	— 14
1953-54	15.51	21.60	36.24	73.35	26.65	34700	3,47,08	— 8
1954-55	14.33	20.43	35.40	70.15	29.84	36812	3,84,04	—15,92
1955-56	12.59	20.17	32.03	64.79	35.21	42081	4,71,37	—50,56
1956-57	12.08	22.76	32.14	66.98	33.02	42608	4,88,93	—62,85

* For explanation to the various items *see* the note to Table XLIII, pp. 193-4.

§ 3. *BUDGETS OF PART B AND C STATES*

PART B STATES

Consolidated Budgetary Position[1]

The consolidated budgetary position of Part B States on

[1] With the reorganization of States from November 1, 1957 the distinction between Part B and C States has ceased to exist.

revenue account during the period 1950-51 to 1956-57 is shown in the following table:

TABLE XLV

Figures in columns 1 to 5 are in percentages.
Figures in columns 6, 7 and 8 are in lakhs of rupees.
Figures in columns 4 and 5 are percentages of Total Revenue as stated in column 6.

	Taxes on Income (*a*)	Taxes on Property and Capital transactions (*b*)	Taxes on Commodities and Services (*c*)	Total Tax Revenue	Non-Tax Revenue (*d*)	Total Revenue	Total Expenditure	Surplus (+) or Deficit (−)
	1	2	3	4	5	6	7	8
1951-52 ..	1.42	18.63	41.35	61.40	38.60	10054	94,37	+ 6,17
1952-53 ..	6.63	20.84	38.33	65.80	34.20	10199	98,74	+ 3,25
1953-54 ..	6.38	21.44	36.92	64.74	35.26	10666	1,01,12	+ 5,54
1954-55 ..	6.79	20.64	34.15	61.58	38.42	11644	1,11,55	+ 4,89
1955-56[1] ..	6.64	20.91	30.81	58.36	41.64	11851	1,33,66	−15,15
1956-57[2] ..	5.94	21.04	29.92	56.90	43.10	12828	1,41,82	−13,54

[1] Revised Figures.
[2] Budget Estimates.
For explanation of (*a*), (*b*), (*c*) and (*d*) *see* Table No. XLIII.

It will appear from the above table that the revenue of Part B States increased from Rs. 100.54 crores in 1951-52 to Rs. 128.3 crores in 1956-57. The percentage of tax revenue and non-tax revenue to the total revenue has 56.90 per cent and 43.10 per cent in 1956-57 respectively.

Revenue of All Part B States

It is desirable to give a broad picture of the major revenues of revenue and expenditure of all Part B States. The following table gives the revenue for all the States for the period 1951-52 to 1956-57.

TABLE XLVI

BUDGETARY POSITION OF PART B STATES

Figures in columns 1 to 5 are in percentages.
Figures in columns 6, 7 and 8 are in lakhs of rupees.
Figures in columns 4 and 5 are percentages of Total Revenue as stated in column 6.

States		Taxes on Income (*a*)	Taxes on Property and Capital transactions (*b*)	Taxes on Commodities and Services (*c*)	Total Tax Revenue	Non-Tax Revenue (*d*)	Total Revenue	Total Expenditure	Surplus (+) or Deficit (−)
		1	2	3	4	5	6	7	8
Hyderabad	..	0.34	18.29	52.03	70.66	29.34	29,58	27,90	+1,68
1952-53	..	9.49	18.82	54.87	83.18	16.82	26,46	25,04	+1,42
1953-54	..	9.98	22.37	48.80	81.15	18.85	25,35	26,49	−1,14
1954-55	..	9.90	22.64	43.83	76.37	23.63	22,17	28,02	− 85
1955-56[1]	..	10.96	23.22	48.38	82.56	17.44	24,37	27,58	−3,21
1956-57[2]	..	10.08	23.60	48.54	82.22	17.78	25,59	29,89	−4,30
Madhya Bharat									
1951-52	..	0.54	26.74	37.76	65.04	34.96	11,07	10,89	+ 18
1952-53	..	8.45	32.04	36.18	76.67	23.33	11,36	11,81	− 45
1953-54	..	6.90	29.90	34.59	71.39	28.61	24,05	12,41	+1,64
1954-55	..	7.17	30.14	31.38	68.69	31.31	14,50	13,71	+ 79
1955-56[1]	..	6.03	26.95	22.16	55.14	44.86	16,92	16,80	+ 12
1956-57[2]	..	5.59	27.16	22.11	54.86	45.14	18,41	18,39	+ 2
Mysore									
1951-52	..	..	13.15	32.57	45.72	54.28	13,91	13,95	− 4
1952-53	..	..	12.30	28.13	40.43	59.5 7	14,47	13,72	+ 75
1953-54	..	0.46	11.96	28.62	41.04	58.96	15,13	15,24	− 11
1954-55	..	0.74	14.02	29.34	44.10	55.90	16,12	16,55	− 43
1955-56[1]	..	0.68	14.61	29.60	44.89	55.11	17,60	20,29	−2,69
1956-57[2]	..	1.48	14.15	27.32	42.95	57.05	18,30	22,19	−3,89
PEPSU									
1951-52	..	2.48	18.68	52.23	73.39	26.61	6,05	4,62	+1,43
1952-53	..	6.72	20.33	45.24	72.29	27.71	6,10	5,34	+ 76
1953-54	..	6.11	20.49	47.24	73.84	26.11	6,88	6,72	+ 16
1954-55	..	5.95	17.70	46.50	70.15	29.85	7,57	8,93	−1,36
1955-56[1]	..	5.68	14.84	43.09	63.61	36.39	7,75	10,42	−2,67
1956-57[2]	..	4.28	15.80	33.23	53.31	46.69	9,81	9,34	+ 47

TABLE XLVI (*Continued*)

States		Taxes on Income (a)	Taxes on Property and Capital transactions (b)	Taxes on Commodities and Services (c)	Total Tax Revenue	Non-Tax Revenue (d)	Total Revenue	Total Expenditure	Surplus (+) or Deficit (−)
		1	2	3	4	5	6	7	8
Rajasthan									
1951-52	..	0.85	24.05	48.88	73.78	26.22	15,22	15,47	− 25
1952-53	..	10.73	25.81	40.11	76.65	23.35	17,90	15,69	+2,21
1953-54	..	10.48	23.55	40.79	74.82	25.18	18,51	17,98	+ 53
1954-55	..	9.67	21.70	35.80	67.17	32.83	21,93	20,04	+1,89
1955-56[1]	..	10.12	28.26	25.73	64.11	35.89	20,95	23,42	−2,47
1956-57[2]	..	8.59	27.89	24.91	61.39	38.61	24,09	25,79	−1,70
Saurashtra									
1951-52	..	..	24.63	14.19	38.82	61.18	7,47	8,58	−1,11
1952-53	..	..	32.55	9.01	41.56	58.44	9,77	11,68	−1,91
1953-54	..	..	34.38	13.73	48.11	51.89	10,56	8,42	+2,14
1954-55	..	..	27.58	13.35	40.93	59.07	12,29	12,27	+ 2
1955-56[1]	..	..	23.70	11.04	34.74	65.26	13,50	16,32	−2,82
1956-57[2]	..	..	23.51	12.32	35.83	64.16	14,22	15,18	−1,06
Travancore-Cochin									
1951-52	..	5.74	11.02	33.70	50.46	49.54	17,24	12,96	+4,28
1952-53	..	6.03	11.42	34.97	52.42	47.58	15,93	15,46	+ 47
1953-54	..	5.38	11.06	34.43	50.87	49.13	16,18	13,86	+2,32
1954-55	..	8.84	10.44	32.98	52.25	47.75	16,86	12,03	+4,83
1955-56[1]	..	8.61	9.87	31.81	50.29	49.71	17,42	18,83	−1,41
1956-57[2]	..	6.96	9.86	32.85	49.67	50.33	17,96	21,04	−3,08

[1] Figures for 1955-56 are Revised Estimates.
[2] Budget Estimates.
For explanation of (*a*), (*b*), (*c*) and (*d*) *see* Table No. XLIII.

It will appear from the above table that the revenue of Part B States varied from Rs. 9.81 crores in the case of PEPSU to Rs. 25.59 crores in Hyderabad. The non-tax revenue was highest in Mysore (Rs. 10.44 crores) and lowest in Hyderabad (Rs. 4.55 crores) which had the highest total revenue. The total revenue of all Part B States increased

from Rs. 100.54 crores in 1951-52 to Rs. 128.28 crores in 1956-57. The budgets for the first four years of the Part B States 1951-52 to 1954-55 were surplus budgets. But for 1955-56 and 1956-57 they were deficit budgets, the deficits were of an order of Rs. 15.15 crores and 13.54 crores respectively.

Coming to a more detailed account, the accounts for 1950-51 of Part B States as a whole showed a surplus on revenue account of Rs. 1.53 crores as against a deficit of Rs. 76 crores in the revised estimates for that year. As compared with the revised estimates, revenue at Rs. 92.83 crores showed a rise of Rs. 36 crores, while expenditure at Rs. 91.30 crores was lower by Rs. 1.93 crores.

The accounts for 1951-52 reveal a surplus of a little over Rs. 6 crores, as against a surplus of Rs. 3 crores in the revised estimates for that year. This was due to a small rise in revenue (Rs. 0.43 crores) and a substantial fall in expenditure (Rs. 2.7 crores), compared to the revised estimates. Four states, namely Madhya Bharat, PEPSU, Hyderabad and, notably, Travancore-Cochin, (Rs. 4.3 crores) recorded surpluses, while the remaining three states had deficits, the largest being in Saurashtra (Rs. 1.1 crores).

The accounts for 1952-53 closed with a surplus of Rs. 3.2 crores, as against a small deficit of Rs. 0.27 crores anticipated in the revised estimates. This was due to a decline of Rs. 6.3 crores in expenditure as against a fall of only 2.8 crores in revenue. Saurashtra and Madhya Bharat incurred revenue deficits, while the remaining five States, notably Rajasthan and Hyderabad, realised surpluses.

The final position in 1953-54 was a surplus of Rs. 6 crores instead of a deficit of Rs. 4 crores envisaged in the revised estimates for that year. This was due to a decline of Rs. 13 crores in expenditure, mainly under development heads, and a fall of Rs. 3 crores in revenue.

During 1954-55 revenue and expenditure were both lower as compared to budget estimates, but as expenditure showed a larger decline, the deficit remained lower only by Rs. 1 crore at Rs. 15.2 crores.

PART C STATES

Consolidated Budgetary Position

The combined revenue account of the six Part C States namely, Ajmer, Bhopal, Coorg, Delhi, Himachal Pradesh and Vindhya Pradesh since 1952-53 is given in the following table:

TABLE XLVII

Figures in columns 1 to 5 are in percentages.
Figures in columns 6, 7 and 8 are in lakhs of rupees.
Figures in columns 4 and 5 are percentages of Total Revenue as stated in column 6.

		Taxes on Income (*a*)	Taxes on Property and Capital transactions (*b*)	Taxes on Commodities and Services (*c*)	Total Tax Revenue	Non-Tax Revenue	Total Revenue	Total Expenditure	Surplus (+) or Deficit (−)
		1	2	3	4	5	6	7	8
1952-53	..	1.14	17.57	30.28	48.99	51.01	1235	12.10	+ 25
1953-54	..	1.44	15.64	26.96	44.04	55.96	1528	13,72	+1,56
1954-55	..	1.40	17.20	27.71	46.31	53.69	1570	16,23	− 53
1955-56[1]	..	1.20	13.07	22.78	37.05	62.95	2081	21,40	− 59
1956-57[2]	..	1.11	12.91	22.94	36.96	63.04	2262	23,64	−1,02

[1] Revised Figures.
[2] Budget Estimates.
For explanation of (*a*), (*b*), (*c*) and (*d*) *see* Table No. XLIII.

From the above table it will appear that the total revenue of the Part C States increased from Rs. 12.35 lakhs in 1952-53 to Rs. 22.62 lakhs in 1956-57. There was a substantial increase in non-tax revenue from Rs. 6,30 lakhs to Rs. 14,26 lakhs during the above period; this increase was higher than that of the total tax-revenue. Similarly the expenditure also increased during the period under review from Rs. 12,10 lakhs

to Rs. 23,64 lakhs. The budgets for 1952-53 and 1953-54 were surplus budgets; but for the three subsequent years namely 1954-55, 1955-56 and 1956-57 the budgets were deficits.

A somewhat more detailed account of the budgetary position of all Part C States is shown in the following table:

TABLE XLVIII

BUDGETARY POSITION OF PART C STATES

Figures in columns 1 to 5 are in percentages.
Figures for columns 6, 7 and 8 are in lakhs of rupees.
Figures in columns 4 and 5 are percentages of Total Revenue as stated in column 6.

States	Taxes on Income (*a*)	Taxes on Property and Capital transactions (*b*)	Taxes on Commodities and Services (*c*)	Total Tax Revenue	Non-Tax Revenue (*d*)	Total Revenue	Total Expenditure	Surplus (+) Deficit (−)
	1	2	3	4	5	6	7	8
Ajmer								
1952-53 ..	..	3.79	12.32	16.11	83.89	2,11	2,08	+ 3
1953-54 ..	..	6.25	19.37	25.62	74.38	1,19	1,45	+15
1954-55 ..	..	5.84	20.78	26.62	73.38	1,54	1,64	−10
1955-56[1] ..	..	3.15	15.35	18.50	81.50	2,54	2,54	..
1956-57[2] ..	..	5.86	26.17	32.03	67.97	2,56	2,56	..
Bhopal								
1952-53 ..	..	22.73	9.60	32.33	67.67	1,98	1,85	+13
1953-54 ..	..	22.94	9.63	32.57	67.43	2,18	2,21	− 3
1954-55 ..	0.38	21.15	8.08	29.62	70.38	2,60	2,68	− 8
1955-56[1] ..	0.28	15.88	5.57	21.73	78.27	3,59	3,65	− 6
1956-57[2] ..	0.60	17.66	10.18	28.44	71.56	3,34	3,41	− 7
Coorg								
1952-53 ..	18.92	9.46	21.62	50.009	50.00	74	65	+ 9
1953-54 ..	23.08	7.69	21.98	52.75	47.25	91	86	+ 5
1954-55 ..	20.00	8.42	20.00	48.42	51.58	95	99	− 4
1955-56[1] ..	18.80	7.69	16.24	42.73	57.27	1,17	1,42	−25
1956-57[2] ..	19.27	9.17	7.34	35.78	64.22	1,09	1,48	−39

TABLE XLVIII (*Continued*)

States	Taxes on Income (*a*)	Taxes on Property and Capital transactions (*b*)	Taxes on Commodities and Services (*c*)	Total Tax Revenue	Non-Tax Revenue (*d*)	Total Revenue	Total Expenditure	Surplus (+) Deficit (−)
	1	2	3	4	5	6	7	8
Delhi								
1952-53 ..	..	12.96	65.08	78.04	21.96	3,78	3,37	+41
1953-54 ..	..	12.68	64.83	77.51	22.49	4,18	3,81	+37
1954-55 ..	..	16.82	65.91	82.73	17.27	4,40	4,18	+22
1955-56[1] ..	..	10.73	58.57	69.30	30.70	5,31	5,78	−47
1956-57[2] ..	..	10.10	50.49	60.59	39.41	6,14	6,60	−46
Himachal Pradesh								
1952-53 ..	..	14.72	9.82	24.54	75.46	1,63	1,60	+ 3
1953-54 ..	..	11.56	8.54	20.10	79.90	1,99	1,92	+ 7
1954-55 ..	..	11.42	7.76	19.18	80.82	2,19	2,21	− 2
1955-56[1] ..	..	7.59	5.28	12.87	87.13	3,03	3,06	− 2
1956-57[2] ..	..	6.23	7.01	13.24	86.76	3,85	3,85	—
Vindhya Pradesh								
1952-53 ..	..	39.81	24.17	63.98	36.02	2,11	2,55	−44
1953-54 ..	0.23	21.72	11.76	33.71	66.29	4,42	3,47	+95
1954-55 ..	0.50	24.81	13.65	38.96	61.04	4,03	4,53	−50
1955-56[1] ..	0.19	22.97	13.32	36.48	63.52	5,18	4,96	+22
1956-57[2] ..	0.53	21.81	12.77	35.11	64.89	5,64	5,74	−10

[1] Figures for 1955-56 are Revised Estimates.
[2] Budget Estimates.
For explanation of (*a*), (*b*), (*c*) and (*d*) *see* Table No. XLIII.

Elasticity in States Budgets

We have now reviewed the trends in public revenues of the Government of India, Part A, B and C States. In concluding the review it may be pointed out that the State revenues are now much more elastic than they were under the Government of India Acts, 1919 and 1935. Before the War the Government of India, with the income-tax, customs and excise duties, had an elastic revenue-system; while the Provinces

with land revenue and liquor excises as their main sources of revenue, had a relatively inelastic revenue-system. This elasticity in State revenue has essentially been brought about by the introduction of the sales tax and a share in the proceeds of Central taxes, viz. income-tax and excise duties. The institution of grants-in-aid by the Government of India, for general and specific purposes, has further imported a measure of elasticity in States revenues, which was unthought of in the pre-war period. Never before in the history of federal finance in India was the financial system of the country more integrated and co-ordinated than it is today. We have already pointed out the role of the Finance Commission in bringing about this integration. The old antagonism between the Central revenue and States revenues has largely disappeared and the finances of the nation are being put to the best possible use.

Our review has pointed out that the revenues of the Government of India increased from Rs. 371.70 crores in 1948-49 to Rs. 768.99 crores in 1958-59,[1] i.e. an increase of about 206 per cent. The State revenues during the above period increased, however, from Rs. 212.04 crores to Rs. 369.44 crores, i.e. an increase of about 174 per cent. This points out that the revenues of the Government of India have increased at a much more rapid pace than the revenues of the State Governments, which have depended to a very large extent, as we have already pointed out, on grants-in-aid and a share in the income-tax and excise duties. Land revenue, which was one of the most important sources of revenue for a long time in the past, has not increased to the same extent as have other sources of revenue. Perhaps one of the most important measures of reform to which the State Governments should pay special attention is the re-orientation of the land-revenue demand especially after the abolition of zamindari.

[1] In the case of States the figures for 1948-49 include the revenues of the then Part A States. Hence for the sake of comparison we have taken the figures for 1958-59 (Budget) for the States which, more or less, represent the former Part A States of 1948-49. In calculating the total revenues of these States, allocations of tax proceeds, subventions and grants-in-aid from the Centre have been excluded for both the years.

X

RAILWAY FINANCE

§ 1. *INTRODUCTORY*

Before we give a detailed account of railway finance, it is desirable to state briefly the present position of the railways in India. The Indian railway system, the largest in Asia and the fourth largest in the world, is the country's biggest nationalised undertaking with a route mileage of 34,744. The railways constitute India's principal means of transport and carry about 80 per cent of the goods traffic and 70 per cent of the passenger traffic. In 1957, on an average, about 38 lakhs of people and about 3.4 lakh tons of goods were carried by the railways daily. The capital-at-charge at the end of 1956-57 was about Rs. 1,078 crores. Gross earnings during the year amounted to Rs. 350.6 crores and the railways employed 10,54,408 persons and paid them Rs. 150 crores in wages and salaries.

The first railway line in India was opened in 1853 and the railways celebrated their centenary in April, 1953. The progress made by the railways during the past one hundred and five years can be seen from Table XLIX.

Before the railways were taken over by the Government in 1944 there was a complicated system of ownership and control. Some railways were state-owned and state-managed, a few state-owned and company-managed, and others company-owned and company-managed. Some Indian States had their own railway lines. The existence of a large number of big and small units resulted in a lack of efficiency in railway administration and reduced the profits of the railways. To effect economy and efficiency in administration, a scheme for the regrouping of the entire railway system was prepared by the Railway Board in 1950; it was gradually enforced between 1951-55. The railways have now been grouped into seven zones: Southern, Central, Western, Northern, North-Eastern, Eastern, and South-Eastern.

TABLE XLIX

PROGRESS OF ALL-INDIA RAILWAYS (1853-1957)[1]

(In lakhs of rupees)

1853 ..	20	38	0.90	0.41	0.49
1863 ..	2,507	5,300	220	133	87
1873 ..	5,697	9,173	723	378	345
1883 ..	10,447	14,831	1,639	797	842
1893 ..	18,459	23,318	2,408	1,135	1,273
1903 ..	26,956	34,111	3,601	1,711	1,890
1913-14 ..	34,656	49,509	6,359	3,293	3,066
1923-24 ..	38,039	71,793	10,780	6,845	3,935
1933-34 ..	42,953	88,441	9,958	6,954	3,004
1943-44(*a*) ..	40,512	85,854	19,932	11,411	8,521
1947-48(*b*) ..	33,985	74,220	18,369	16,394	1,975
1948-49 ..	33,861	77,588	23,412	18,406	5,006
1949-50 ..	34,002	81,307	25,832	20,723	5,109
1950-51 ..	34,079	83,818	26,462	21,439	5,023
1951-52 ..	34,119	86,155	29,414	22,759	6,655
1952-53 ..	34,275	86,855	27,228 (*c*)	21,999 (*c*)	5,229 (*c*)
1953-54 ..	34,406	87,845	27,281	23,199	4,082
1954-55 ..	34,705	91,091	28,859	23,599	5,261
1955-56 ..	34,736	97,550	31,751	26,107	5,734
1956-57 ..	34,744	1.07,823	35,055	28,013	7,042

[1] See *India*, 1958.
(*a*) Burma railways separated in 1937.
(*b*) Following the Partition of August 15, 1947.
(*c*) Excludes the freight charges for railway stores, fuel, etc., which are treated as rehauled traffic with effect from April 1, 1952.

§ 2. *RAILWAY CONVENTIONS*

The history of railway finance is an oft-told tale, but must be briefly summarized here if we are to understand to what extent the railways are contributing towards the general finances of the Government of India.

The financial position of the railways was fully examined and reported upon by the Ackworth Committee in 1921. The question of separating the railway finance from the General Budget was discussed in the Legislative Assembly in 1924. After considerable opposition a compromise was reached in the so-called 'Convention' of 1924 which determined the annual contribution of the railways to the Central Budget.

In 1925-26 the Railway Budget was for the first time separated from the General Budget.

Under the terms of the Railway Convention the Central Exchequer was entitled to receive from the railways a sum equal to 1 per cent of the capital-at-charge in the penultimate year plus one-fifth of the surplus profits in that year. This was the fixed contribution from the railways. If after payment of this fixed contribution, the amount available for transfer to the railway reserves exceeded Rs. 3 crores, one-third of that excess amount was to be paid to the general.

Railway Budget Convention, 1949

This Convention, as modified in 1943, continued till 1949 when, as a result of the recommendations of the Railway Convention Committee, the Constituent Assembly on December 21, 1949 passed a revised Railway Convention to determine the future contribution of the railways to the General Budget.

The Railway Convention Committee made the following recommendations, which form the present basis of the relationship between General and Railway Finance:

(1) The present relationship between General and Railway Finance should be altered to give the Government of India the status of sole shareholder in the railway undertakings and General Finance should be guaranteed, for a period of five years from 1950-51, a fixed dividend at 4 per cent on the loan capital invested as computed annually. This arrangement should be reviewed towards the close of the five-year period.

(2) The annual contribution to the Depreciation Fund should be a minimum of Rs. 15 crores for the five-year period and the full cost of replacement should be charged to this fund.

(3) A Development Fund should be constituted from the surpluses of prosperous years, the existing Betterment Fund being merged with it. The Development Fund will provide for passenger amenities on a scale commensurate with the status of the undertaking and for labour welfare and will finance projects which may be necessary but unremunerative to begin with. The scope of the Revenue Reserve Fund, which would

replace the Railway Fund, should be limited to ensure payment of the fixed dividend to General Revenue and to finance any deficit in the Railway Budget.

(4) With the integration of the States' Railways with the Indian Government Railways, two separate accounts—a loan account and a block account—should be maintained. The loan account will represent the share capital of the railways, while the block account will represent the physical assets of the railways whether financed from loan capital or revenue.

Railway Convention, 1954

A significant development during the year 1954-55 was the submission of the Report of the Railway Convention Committee in November, 1954. The Committee was appointed in 1954 in terms of the Convention Resolution of December, 1949 to examine *inter alia*, (i) the rate of dividend payable by the railways to General Revenue; (ii) the allocation of railway expenditures as between capital and revenue account and (iii) the appropriations to be made to each of the three Railway Funds, viz. the Depreciation Reserve Fund, the Development Fund and the Revenue Reserve Fund.

According to the Committee, the practice under the Convention, 1949 for payment of a fixed rate of dividend on capital-at-charge of the railways to the General Budget was to be continued. As regards the rate of dividend, the Committee recommended that the existing rate of 4 per cent on capital-at-charge should remain unaltered for a period of 5 years from 1955-56. The Committee, however, recommended a lower rate of dividend on the element of over-capitalization, estimated roughly at Rs. 100 crores, and on outlays on the construction of new lines.

As regards the contribution to the Depreciation Reserve Fund, the Committee recommended the raising of the annual appropriation from Rs. 30 crores to Rs. 35 crores in the next five years, in view of the increase in depreciable assets of railways as a result of annual additions to stock. The Committee also suggested that the cost of replacement of assets created out of withdrawals from the Development Fund should also be met out of the Depreciation Reserve Fund.

Regarding the Development Fund, the Committee recommended that the entire expenditure on unremunerative operating improvement works costing more than Rs. 3 lakhs each and outlays on quarters for Class III and IV staff should be financed from this fund in addition to the present practice of earmarking Rs. 3 crores for the provision of amenities to passengers. The Committee made no specific recommendation about the appropriation to the Revenue Reserve Fund.

Finally, the Committee recommended that the position of railway revenues should again be reviewed at the end of the next quinquennium by a Parliamentary Committee.

These recommendations were adopted in the Railway Budget for 1955-56.

The above arrangement has not only assured to the General Revenue a definite return on capital-at-charge thus facilitating forward economic planning in the civil field, but at the same time will afford an opportunity to the railways to build up adequate reserves in years of prosperity to ensure a minimum return to the General Revenue in years of depression.

§ 3. *RAILWAY REVENUE*

An important feature of post-Partition railway finance has been the continuous rise in traffic receipts from Rs. 210.10 crores in 1949-50 to Rs. 385 crores in 1957-58. We give below a brief account of the railway budgets from 1949-50.

The accounts for 1949-50 showed a surplus of Rs. 14.59 crores as compared with a surplus of Rs. 11.02 crores in the revised estimates. The gross traffic receipts of Rs. 236.35 crores were larger than the revised estimates by Rs. 11.20 crores, due to an increase under almost all heads of earnings. Ordinary working expenses were also higher by Rs. 8.53 crores at Rs. 181.53 crores (including the special adjustment of Rs. 15 crores for inflationary and improvement elements in the cost of replacement works). Rs. 7 crores from the surplus were paid to the General Revenue and the balance was credited to the Depreciation Reserve Fund.

According to the accounts for 1950-51, gross traffic amounted to Rs. 263.01 crores and ordinary working expenses

to Rs. 180.23 crores. Making allowance for appropriation to the Depreciation Reserve Fund (Rs. 30 crores), payments to worked lines (Rs. 0.25 crore), net miscellaneous expenditure (Rs. 4.97 crores) and payment of Rs. 32.51 crores as dividend to General Revenue, the net surplus was Rs. 15.05 crores as compared with Rs. 14.24 crores in the revised estimates for the year and Rs. 7.59 crores in 1949-50. Of the net surplus, Rs. 10 crores were credited to the Development Fund and the balance of Rs. 5.05 crores to the Revenue Reserve Fund.

The net revenue of the railways in 1951-52 amounted to Rs. 61.7 crores which, after payment of Rs. 33.4 crores as dividend to General Revenue, left a net surplus of Rs. 28.3 crores. Of this, Rs. 10 crores were allocated to the Development Fund and the balance to the Revenue Reserve Fund.

The actual surplus for 1952-53 was Rs. 13.2 crores, or Rs. 3.7 crores larger than in the revised estimates, due to an increase in gross traffic receipts, a decline in expenditure and a lower contribution to General Revenue. Out of the surplus, Rs. 12 crores were allocated to the Development Fund and the balance to the Revenue Reserve Fund.

The increase in receipts over the revised estimates for 1953-54 was more than offset by the rise in total working expenses. In consequence, the appropriation to the Development Fund, after setting aside the dividend (Rs. 34 crores) to General Revenue, amounted only to Rs. 2.6 crores as compared to the revised estimate of Rs. 3.2 crores.

The final outturn for 1954-55 recorded an increase of Rs. 3.9 crores in gross earnings, to Rs. 286.8 crores, as against a rise of Rs. 1.4 crores in total expenses, to Rs. 242.7 crores, as compared to revised estimates. The surplus of Rs. 9.1 crores was, therefore, higher than in the revised estimate (Rs. 6.6 crores) and was wholly appropriated to the Development Fund.

During 1955-56 with receipts higher by Rs. 2.1 crores at Rs. 316.3 crores over the revised estimates, and expenditure lower by Rs. 2.4 crores at Rs. 266.0 crores, the surplus, after payment of dividend to General Revenue, was higher at Rs. 14.2 crores as against Rs. 9.6 crores in the revised estimates; of this, half was allocated to the Development Fund and the rest to the Revenue Reserve Fund.

Traffic receipts (excluding freight on railway materials) were estimated higher at Rs. 385 crores in 1957-58 (revised estimates) as compared to Rs. 348 crores in 1956-57; they were expected to rise further to Rs. 408 crores in 1958-59. Total expenses did not increase to the same extent and were placed at Rs. 331 crores as against Rs. 319 crores in 1957-58 (revised estimates) and Rs. 290 crores in 1956-57. Consequently the net revenue shows a rising trend from Rs. 58 crores in 1956-57 to Rs. 66 crores in 1957-58 (revised estimates) and further to Rs. 77 crores in 1958-59. Surplus available to the railways after payment of dividend to General Revenue showed an increase from Rs. 20 crores in 1956-57 to Rs. 22 crores in 1957-59 (revised estimates).[1]

§ 4. *THE PLANS AND THE RAILWAYS*

In concluding this account of railway finance we may briefly refer to the railway development programme under the Plans. The main problem of the railways in recent years has been rehabilitation and replacements. It was first created by the economic depression of the thirties and later accentuated by the severe strain of the War and Partition. By 1948, however, the railways had turned the corner and have since been showing steady improvement. Under the First Five-Year Plan, Rs. 400 crores were allotted for the rehabilitation and expansion of the railways, of which Rs. 320 crores were to be contributed by the railways themselves. Actual expenditure during the First Plan period amounted to Rs. 423.73 crores. The position of the railway reserve funds has also been very satisfactory. At the end of 1955-56, the reserves were estimated at about Rs. 163 crores.

During the First Plan period, 430 miles of dismantled lines were restored, 380 miles of new lines were constructed and 46 miles of narrow gauge lines were converted into metre gauge. At the end of the Plan period, 453 miles of new lines were under construction, 52 miles were in the process of being converted into broad gauge, and surveys for over 2,000 miles of new lines were in progress.

By the end of the Second Plan period, goods traffic is

[1] See *Report on Currency and Finance* for several years.

expected to go up by about 60.8 lakh tons, and passenger traffic by 1,950 lakhs or by 15 per cent. With a view to meeting this heavy demand, a development programme costing Rs. 1,125 crores has been adopted. The main features of the development programme are: doubling of 1,607 miles of track; conversion of 265 miles of metre gauge lines into broad gauge; electrification of certain sections totalling 825 miles; dieselisation of 1,293 miles; construction of 842 miles of new lines; renewal of 8,000 miles of obsolete track; procurement of 2,258 locomotives, 1,07,247 wagons and 11,364 coaches.

Out of a total proposed Plan outlay of Rs. 4,800 crores in the public sector, the railways have been allotted Rs. 900 crores, of which they will themselves find Rs. 150 crores. An additional sum of Rs. 225 crores will be spent as their contribution to the Railway Depreciation Fund. The principal items of expenditure in the total Railway Plan of Rs. 1,125 crores are as follows:

	Expenditure (in crores of rupees)
Rolling stock	380
Line capacity including expansion of goods sheds ..	186
Track renewals	100
Electrification	80
New constructions	66
Workshops, plant and machinery	65
Staff welfare and staff quarters	50
Bridge works including Ganga Bridge ..	33
Signalling and safety works	25
Railway users' amenities	15
Railways' share in road transport undertakings ..	10
Other projects, stores depots, etc.	115

From the account given in the foregoing pages it is safe to infer that not only would the railways contribute handsomely to the general finances of the country but they would also reduce their rates of expenses and put their house in order. There can be no doubt that they would certainly be credited with the lion's share in the future promotion of India's economic progress.

XI

LAND REVENUE

§ 1. *ABOLITION OF ZAMINDARI*

Introductory

Indian land policy during the past few years has undergone profound changes. The two most important changes to which attention may be drawn are: (i) the abolition of the Permanent Settlement; and (ii) the abolition of the zamindari system. A brief account of the land laws passed by some of the State Governments will be given in the following pages.

Before we describe some of the important features of the recent land reforms it may be pointed out that the revenue system which fitted in with the economic and political tendencies of British rule was not in harmony with the present economic situation. Historically, the land-revenue system as it existed at the close of British rule was a product of political forces. Its evolution had closely followed the power which the landlords or peasants wielded in the body politic of the country. Thus throughout British rule the landlords had the upper hand in shaping land policy, as the alien rulers had to depend upon their support. A popular Government depends upon the will of the people. This change in the complexion of the Government is, to some extent, responsible for the abolition of the zamindari system and land reforms.

The first half of the nineteenth century was a period of conquest and consolidation of British power. The main object of the East India Company was the realization of a large amount of revenue necessary for the wars in which the Company was engaged. There was little opportunity in such a disturbed period to base the land-revenue system on sound theoretical principles. During the second half of the nineteenth century, with the development of the means of transportation and communication, the economic unification of the country had begun. It was in this period that all the work of survey and settlement was completed and the land-revenue demand

was placed on principles which, even today with slight modifications, form the basis of land assessment. Lord Curzon's famous Resolution of 1902 is a landmark in the history of land-revenue policy.[1] It was an emphatic assertion of the success of the land-revenue policy. However, it did not advocate any fundamental change in the principles of assessment.

With the rise and establishment of British rule a very important change appeared in the fiscal system of the country. Under Moghul rule the policy of tax-exemptions was a part of the political and fiscal system of the country. In return for political support the nobility was freed from tax payments. With the consolidation of British power these political privileges were abolished. The abolition of these privileges marked the emergence of two important principles of taxation: the *universality* and the *uniformity* of taxation.

The first principle means that no person who has an income from land may escape taxation; the second, that all those who enjoy similar economic privileges from land should be subjected to the same fiscal treatment. Proportional taxation, which taxes wealth objectively, that is, it taxes 'objects' and not 'persons', was the most convenient way to put these principles in the land policy of the country. Herein lies the origin of treating land revenue as a tax *in rem*.

It should not be inferred that this feature of land taxation was peculiar to India. Before the French Revolution the French nobility was exempt from the payment of land taxes and the greater burden of taxation was on the poor peasantry. With the emergence of the third estate after the French Revolution, in proportional taxation the poor and middle classes found a weapon to transfer the tax burden on to the wealthier classes. Proportional taxation is eminently suited to abolish class privileges. It was this objective, non-personal character of the proportional system, observed Professor De Viti, that led to its being carried into effect by the men of the Revolution, who wished, above all, to protect themselves against the danger of a return to those privileges.[2]

[1] *Government Resolution (East India) on Land Revenue*, Cmd. 1089, 1902, Government Press, Calcutta.

[2] De Viti, op. cit. p. 7.

The land policy of British rule, however, needed a revision under changed political and economic conditions. The recent agricultural policy of the Government, especially in the field of irrigation, scientific research and co-operation, necessitated a new outlook with regard to the duty of the Government towards the cultivators. The aim of tenancy legislation throughout India has been to lighten the burden of the peasants and to save them from the vexatious exactions of the landlords. But all these measures, good in themselves, merely patched the old machine of the nineteenth century. For neither scientific agriculture nor co-operation could improve the condition of the peasantry unless the zamindari system was abolished and bold measures were taken to distribute more equitably rental burdens between the different classes of peasants.

Abolition of Permanent Settlement

One of the most important problems of land revenue which had created inter-provincial inequalities and an unfair distribution of tax burdens is that of the Permanent Settlement. The history of the Permanent Settlement is an oft-told tale and need not be repeated here. It was one of the most important defects of the land-revenue system introduced by British rule. It thoroughly crippled the finances of Bengal, Bihar and Orissa. It resulted in a colossal loss of revenue to the Government. Above all, it created an unfair distribution of tax burdens between zamindars and ryots and other classes of society. Unfortunately the greatest mistake in the terms of the Permanent Settlement was that while the revenue demand was taken to be fixed, the rents of the ryots were left at the mercy of competitive forces.

The abolition of the Permanent Settlement in the States of Bihar, Bengal and Orissa has been one of the major achievements of the Government. In its abolition there is no question of breach of faith, for after the lapse of a century and a half the original contract based on loyalty in troublous times had lost much of its value.

The abolition of the Permanent Settlement would rehabilitate State finances, distribute tax burdens equitably

between different sections of the peasantry and make land revenue a fairly elastic source of revenue.

The glaring injustice of the Permanent Settlement to the people of other States is apparent from the following table:

States	Total Revenue 1952-53	Land Revenue 1952-53	Percentage of land revenue to total revenue
	(In lakhs of rupees)		
Assam	10,05	1,65	16.42
Bihar	31,43	1,59	5.1
Bombay	61,54	6,30	10.24
Madhya Pradesh ..	20,74	4,56	22.0
Madras ..	63,90	7,78	12.2
Orissa	11,78	1,07	9.1
Punjab	16,92	1,95	11.5
Uttar Pradesh ..	62,55	14,77	23.6
West Bengal ..	35,91	2,07	5.8

It is clear from the above table that the income from land in Bengal and Bihar, in spite of high fertility, comparative immunity from famine conditions, and the cultivation of money crops like jute and rice, is far less than that in other States. The result has been that the Permanent Settlement in Bengal and Bihar, while benefiting the small minority of zamindars in these States, necessitated the imposition of heavier tax burdens.

Abolition of Zamindari System

Perhaps one of the most outstanding achievements of the Congress Government is the abolition of the zamindari system, particularly in the landlord-ridden States of the U.P., Bihar and West Bengal. In the States of Bihar, West Bengal and Orissa the Permanent Settlement has also come to an end with the abolition of the zamindari system. During no period of land history was there a greater acceleration in the tempo of land reforms in India than after independence. Within a space of a few years no less than thirty laws or regulations were enacted

in different States for the abolition of the zamindari or intermediaries.

Soon after 1947, *ad hoc* committees for examining the various issues connected with the land reforms were set up in U.P., Hyderabad, Saurashtra, Rajasthan and Madhya Bharat. The Madras Assembly passed a Resolution accepting the general principle of zamindari abolition and the Bihar Government introduced the Zamindari Abolition Bill in the State Assembly soon after the Congress Ministry came into power. The Assam Assembly passed the Assam State Requisition of Zamindari Bill in 1949. The Madras State Abolition and Conversion into Ryotwari Act received the assent of the Governor-General on April 2, 1949. The Bihar and Madhya Pradesh Zamindari Abolition Acts received the assent of the President on January 21, 1951; the U.P. Act on January 24, 1951; the Madhya Bharat Act on July 5, 1951; the Assam Act on August 27, 1951 and the Orissa Act on January 23, 1952. Bombay which was mainly a ryotwari State passed a number of Acts abolishing special tenures such as *Bhagdari*, *Narwadari*, *Maleki Mehwassi* which prevailed in different parts of the State. In the Punjab the right of *Ala Maliks* and landlords of occupancy tenants were extinguished under the Presidents Acts adopted during 1951. PEPSU also passed an Act for abolishing the system of occupancy tenants. Rajasthan, Hyderabad, Madhya Bharat and Saurashtra have passed measures for abolition of the Jagirdari system. Kutch brought Jagirs and Inam lands under assessment as a first step to abolition of the Jagirdari system.

Objectives of Land Reforms

It is difficult to describe as a whole the recent agrarian reforms undertaken by the State Governments in India. The type of land tenure, settlement and tenancy legislation differs from State to State. The abolition of the zamindari system and the rights of intermediary tenure-holders required a large and intricate course of legislation. But behind the tenurial changes and content of reforms legislation there are some broad objectives underlying the general policy of reform. They may briefly be stated as follows:

1. Increase of agricultural production by a better system of land tenure; 2. reduction of inequalities in opportunities and income; 3. security of tenure for tenants including opportunities for them to become owners of the land they cultivate; 4. improvement of the position of landless labourers; 5. in fine, raising the standard of living of the masses who depend upon land as a source of their livelihood.

Broadly speaking the reforms have affected the interests of the following five groups of persons:

1. Landlords; 2. large landowners; 3. owners of small and middle-sized plots; 4. tenants-at-will; and 5. landless labourers.

With the abolition of zamindari all intermediary rights between the occupier of land and the State have been eliminated. Property rights in land now vest in the State. This is the most important objective which the State has kept in view in changing the agrarian structure of the country.

The problem of land held by large owners falls into two broad categories, viz.

(1) land now held under cultivation by tenants-at-will; (2) land held under the direct management of the owners. In respect of the first the objective has been to fix a limit of the area which the landlords could resume for personal cultivation. This area is usually known as *Sir* or *Khudkasht* land in some States. The landowner cannot acquire more than a certain area for cultivation with his own labour and capital. The tenants-at-will, cultivating lands in excess of what the landowner can cultivate, have secured security of tenure and facilities have been given for the acquisition of the rights of ownership. Besides, in dealing with substantial owners of land a ceiling has been fixed prescribing the maximum amount of land which individuals can hold for personal cultivation.

Regarding the reforms relating to middle and small farmers the aim of the policy has been to consolidate the fragmented holdings, prevent sub-division below a certain minimum area and encourage production as far as possible with co-operatives.

In respect of tenants-at-will the object of the policy is to prescribe a minimum period of tenancy which ordinarily should be from five to ten years and which should be renewable.

As regards the determination of fair rents the reforms aim to fix the maximum rent between one-quarter and one-fifth of the produce.

Finally, the reforms have improved the economic position of the agricultural workers. The Minimum Wages Act is now being implemented in different States and permanent rights in house sites are being vested in them. Preference is given to landless labourers in the allotment of lands, taken over from large owners, in newly reclaimed lands and in *Bhoodan* lands. Indeed the most important objective of the *Bhoodan* movement is to settle the landless labourers in rural areas.

Features of Agrarian Legislation

Coming to the features of the reforms, the most striking feature of the recent agrarian legislation is its scope. Millions of cultivators and large areas of land representing the majority of the population and a substantial proportion of farmland are affected.

Secondly, the aim of the reforms is not the abolition of large estates as such, their principal objective is to abolish all property rights in land, such as zamindari and its various intermediaries between the actual tillers of the soil and the State. Thus the criterion for zamindari abolition is not the *size* of the holding, but the form of land tenure, the object being to do away with the rent-receiving landlords or intermediaries who were devouring the meagre produce from land. Most of the Acts contain provisions restricting the letting and sub-letting of land, except under special conditions (e.g. in the case of minors or women). These restrictions, combined with provisions for ceilings on land, would encourage self-cultivation and may lead to the gradual disappearance of tenancy.

The third important feature of the reforms is that the beneficiaries under them are the existing cultivators who have been provided with a greater security of tenure. Some of the Acts confer on specified classes of tenants the right to acquire superior rights which would make them proprietors or quasi-proprietors of their holdings. The reforms have not merely changed the size of the farm unit, or the type of farming;

the main change lies in greater security provided by ownership and increased income which may accrue to the cultivator as a result of the change of ownership.

The above is a brief summary of the objectives and the features of the land reforms recently adopted by the various States. The reforms have been brought about in a peaceful manner and form a part of the wider institutional changes. The Government of India in its reply to the United Nations Report on *Progress on Land Reforms* pointed out that the cardinal aim of policy is to work out a co-operative system of land management in which the entire land and other resources of the village will be so managed and developed as to increase and diversify production and provide fuller employment to all the people working on the land. It may, however, be kept in view that these reforms are the forerunners of wider changes in the future agrarian structure of the country. The future agrarian pattern, to meet the needs of the rapid industrial development and growth of population, is likely to be based on a co-operative economy basis.

§2. *AGRARIAN LEGISLATION*

A State by State description of the important provisions of the Acts may involve repetition; hence it is desirable to state their main provisions under the following two main heads:

1. Compensation;
2. Status of tenants.

Compensation

Article 31 of the Constitution provides for payment of compensation for compulsory acquisition of property for public purposes and requires that all Acts for this purpose must be reserved for the assent of the President. All such Acts should also either fix the total amount of compensation or specify the principles on which and the manner in which compensation is to be paid. No discrimination is permitted against any person in the matter of payment of compensation. Hence all the Acts which have abolished zamindari or

intermediary rights or interests in land have provided for the payment of compensation.

The actual method of assessment of compensation and the manner of its payment differs from State to State. The two important factors determining the amount of compensation are whether the 'individual' proprietor or the 'estate' is the basis for calculation of compensation. In Bihar and U.P. the individual is the basis; in Assam, Orissa, Madras, Madhya Pradesh, and Madhya Bharat the unit is the 'estate' or tenure. This basis of assessment is of material importance as the multiple of the whole estate will be smaller, while for the individual intermediary the multiple will be larger. In the State of Bihar, to obviate this possibility, the interests of one intermediary are treated jointly. In Orissa, although the compensation is determined for the estate as a whole, the tenures and under-tenures under an intermediary are treated as separate estates for purposes of compensation.

The rate of compensation is calculated on the basis of 'net income' in Assam, Bihar, Madhya Pradesh and Orissa; on the basis of 'annual sum' in Madras and on 'net assets' in U.P. The basis for the calculation of net assets, net income and the basic annual sum is not uniform in all the Acts. Broadly speaking the net assets and net incomes are calculated by deducting from the aggregate income accruing to the landlord the expenses paid by way of land revenue, cess, agricultural income-tax, local taxes, cost of management and recoverable arrear rents.

The basic annual sum, as for example in Madras, is to be calculated on the basis of gross annual ryotwari demand and the average net income derived from *lanka* lands other than those in respect of which ryots are entitled to *ryotwari patta*.

The basis for calculating the gross income is again not uniform in all the States. In Assam, averages for the past 15 years have been taken for the purpose; while in Bihar, Orissa, Madhya Bharat figures for the preceding agricultural year constitute the basis. In U.P. and Madhya Pradesh the basic period is different for different items. The deductions for the cost of management and recoverable arrears of rent are also

different. Thus in Madras and U.P. deductions are at an average rate of 15 per cent of gross income, while in Assam, Bihar, Orissa, Madhya Pradesh and Madhya Bharat they are calculated on a sliding scale ranging from 5 to 15 per cent.

The 'net assets' and 'net income' are multiplied at a flat rate to find out the compensation in U.P., Madhya Bharat, Rajasthan and parts of Madhya Pradesh. The multiple is eight times in U.P.; and ten times in Rajasthan and parts of Madhya Pradesh. In Madhya Bharat the multiple is eight times under the Zamindari Abolition Act and seven times under the Abolition of Jagirs Acts.

The sliding rates adopted in some other States are:

Assam and Orissa	3 to 15 times
Bihar	3 to 20 times
Madras	12½ to 30 times
Madhya Pradesh (Merged Territories)	2 to 20 times

The income from mines is sometimes taken into consideration in the calculation of net income. Some States like Bihar and Orissa, however, have laid down a separate procedure for fixing compensation of mines.

The provisions for the payment of compensation for the special tenure rights in the Punjab and Bombay are rather complicated and may be summarised briefly as follows:

In the Punjab two Acts were passed to prescribe compensation to *Ala Maliks* and landlords of occupancy tenants viz. (i) The Punjab Abolition of *Ala Malkiyat* and Talukdari Rights Act, 1951 and (2) the Punjab Occupancy Tenants (Vesting of Proprietary Rights) Act, 1951. The compensation in the case of *Ala Maliks* is to be paid by *Adna Maliks*, but where an *Ala Malik* gets a share of his annual rent or dues also from the Government, the latter shall also have to pay a proportionate share of the compensation. The compensation of an *Ala Malik* shall be equal to 8 times the amount of his annual rents or other dues. In the case of landlords of occupancy tenants, different methods have been prescribed for different classes of occupancy tenants and for different forms of rents paid by them. If, for instance, rents are expressed

in terms of land revenue, a portion of land revenue, varying according as to whether or not the rights of occupancy accrued under Section 5 of the Punjab Tenancy Act, shall be added to the rent and the sum so obtained shall be multiplied by 25 to arrive at the amount of compensation. In case the whole of the rent is paid by apportioning the produce, the amount of compensation (subject to a maximum of one-fourth of the market value of land) shall bear the same proportion to the average market value of the land as the landlords' share bears to the entire produce. As in the case of compensation for *Ala Maliks*, the average value of land, rents and prices shall be determined on the basis of the figures for the 15 years beginning from July 1, 1935.

In Bombay, the Acts for the abolition of special tenures generally lay down that any person whose rights are extinguished or modified under the Acts may apply to the Collector for compensation. Barring such rights for which maximum or standard rates of compensation have been laid down under some of the Acts, the Collector shall be guided by the provisions of sub-section (i) of Section 23 and Section 24 of the Land Acquisition Acts, 1894 in fixing the amount of compensation. The maximum rates of compensation for certain rights have been prescribed under the Khoti Abolition Act, Maleki Tenure Abolition Act, the Panch Mahals Mehwassi Tenure Abolition Act, Taluqdari Tenure Abolition Act, and the Watwa Wazifdari Rights Abolition Act. Besides making a general provision for compensation, some of the Acts like the Watan Abolition Act, have provided more specifically for the payment of compensation to a holder or registered representative *watandar*. A person registered as a representative *watandar* shall be entitled to receive annually as compensation a sum equal to one-third of the total amount of the emoluments payable annually in cash to the representative *watandar* who performed such service in the preceding year. Apart from the payment of compensation, the Khoti Abolition Act provides for the payment of *khots*' dues on a commuted basis by the tenants.[1]

[1] See *Agricultural Legislation in India*, Vol. IV, *Land Reforms*, Government of India, New Delhi, 1953, pp. xiii and xiv.

Rehabilitation Grants

In order to give relief to smaller landlords or intermediaries, provision is made for the payment of a Rehabilitation Grant to them in addition to compensation. The grant is payable to intermediaries who pay land revenue up to Rs. 10,000 in U.P., Rs. 3,500 in Madhya Bharat, Rs. 60 in Madhya Pradesh. The Madhya Pradesh and Madhya Bharat Acts have further laid down that the Rehabilitation Grant shall only be paid to proprietors who derived their livlihood wholly or mainly from agriculture.

Mode of Payment

The mode of payment also differs from State to State. It also depends upon the amount of compensation. In Madras the State Government was required to deposit the amount of compensation in one or more instalments with a tribunal set up under the Act. The actual payment of compensation to individuals was left to the tribunal in such forms and manner as was laid down under the rules. In U.P., Bihar and Madhya Pradesh the payment has been made in cash or in bonds or partly in cash and partly in bonds as laid down under the Acts. The bonds are of a guaranteed value maturing within a period ranging usually from 20 to 40 years. They are negotiable or non-negotiable as prescribed by the Acts. In Assam the payment may be entirely in cash up to Rs. 2,500 and for amounts exceeding this figure 2½ per cent shall be paid in cash and the balance partly in cash and partly in bonds. According to the Orissa Act the compensation, together with the interest, shall be paid in 30 equal annual instalments. Under the Madhya Bharat Zamindari Abolition Act, the compensation is to be paid in instalments not exceeding a period of ten years. The bonds are payable in 40 annual instalments in Bihar, 30 in Madhya Pradesh, 20 in Assam; and equated half-yearly instalments over a period of 40 years in U.P. The State Governments, however, have the right to make full payment at an earlier date.

Interim Compensation

In order to avoid hardship, due to delay in payment of

compensation, provision has been made for the payment of interim compensation under all the Acts. The interim compensation was paid only during or after the lapse of a specified period from the date of vesting and it generally bore a definite relationship to the probable amount of compensation. In Madras where the determination of gross ryotwari demand and the basic annual sum and total compensation was to take a considerable time, the Act provides for the deposit of half of the compensation on a rough basis within six months. Interim compensation in Assam and U.P. was to the extent of 2½ per cent of the probable compensation; in Orissa 1/3 per cent and in Madhya Pradesh, Madhya Bharat and Rajasthan 10 per cent. In U.P. the amount of interim compensation payable to the intermediaries was to be determined according to the rules framed under the Act. Under the Bihar Land Reforms Act the intermediaries were given interim compensation on a half-yearly basis at 3½ per cent per annum when the amount of compensation was less than Rs. 50,000 and 2½ per cent per annum for higher amounts. Generally speaking, in most Acts the interim compensation was paid when compensation could not be determined or paid within the specified period. Such payment, however, was offset against the amount of final compensation.

Status of Tenants

Some of the most important provisions under the Acts relate to the position of the tenants and sub-tenants after the abolition of zamindari rights. The provisions entitle the tenants to improve their status by purchasing superior rights by paying a specified amount of money. Since this is the most important aim of the land-reform policy a State-wise description of the changes brought about under the Acts is desirable even though it may involve some amount of repetition.

Assam

Under the Assam Act, the ryot having occupancy rights under the Goalpara Tenancy Act and the Sylhet Tenancy Act or holding the land continuously for a period of not less than

ten years prior to the date of notification shall have the status of a landholder as defined in the Assam Land and Revenue Regulation, 1886. Other ryots shall get the status of settlement-holders. The under-ryots as defined in the Assam (Temporarily Settled District) Tenancy Act 1935, provided that an under-ryot who has already acquired a limited right of occupancy under Section 41(a) of the Goalpara Tenancy Act of 1929, shall continue to enjoy the same right.

The ceiling fixed for settlement of land with a settlement-holder is appreciably below the ceiling for the settlement of land with the landowner or tenure-holder, the former being 150 bighas as against 400 bighas in the latter case. The ceiling, however, is relaxable in the case of a co-operative society or a family consisting of more than 12 members or individuals undertaking large-scale farming through mechanical appliances.

Orissa

Under the Orissa Act the tenants (other than those holding land on favourable terms for personal service to intermediaries or village servants) shall continue to hold the land under the Government on their existing terms and conditions. But the tenants who held land on favourable terms for personal services to the intermediaries shall be discharged from the continuance of such services and the land may be settled with them in such manner and under such terms and conditions, as may be prescribed.

Madhya Pradesh

Under the Madhya Pradesh Act, persons who immediately before the date of vesting were in possession of holdings as absolute occupancy or occupancy tenants in the Central Provinces, or as tenants in the merged territories or as specified tenants in Berar, shall continue to hold the same as tenants for the State on terms and conditions governing them before the date of vesting. Every absolute occupancy tenant and occupancy tenant has the right to acquire the right of *malik makbuza* by paying to the Government within the prescribed period an amount equal to 3 times and 4 times respectively

the annual rent payable by him to his holding. Similar provisions also exist for tenants in merged territories and Berar.

Bombay

The Bombay Acts generally specify the persons who shall be considered as occupants within the meaning of the Bombay Land Revenue Code, 1879 in respect of the lands in their possession. Thus under the Mehwassi Tenure Abolition Act, every *mehwassdar* holding land under a *mehwassi* lease in the village and every registered occupant in respect of the land in his possession is declared as occupant thereof. Similar provisions exist under the Taluqdari Abolition Act and Khote Abolition Act. The tenants can also acquire occupancy right by paying a price equivalent to a certain multiple (6 or 12 times) of the survey assessment fixed on the land.

Madras

Under the Madras Act every ryot in an estate is entitled to *ryotwari patta* in respect of:

all *ryoti* lands which are not either *lanka* lands or lands in respect of which a landholder or some other person is entitled to a *ryotwari patta*;

all *lanka* lands which have been in his occupation or in that of his predecessor continuously from the first date of July, 1939. However, no person who has become a ryot on or after July 1, 1945 shall be entitled to a *ryotwari patta* in respect of the land concerned.

Uttar Pradesh

Uttar Pradesh was perhaps the most important landlord-ridden State in India. Besides zamindari, it had also the talukdari type of tenure. All through British rule the landlords and talukdars had exercised a most powerful influence on the Government. A somewhat detailed account of the U.P. Zamindari Abolition Act may perhaps be not out of place in pointing out the fundamental changes it has brought about in the economic status of the peasantry. The Zamindari

Abolition Act has classified tenants into the following three classes: i. *Bhumidhar*, ii. *Sirdar*, and iii. *Asami*.

Bhumidhar

The Bhumidhar is the highest type of cultivator created under the Act. The bhumidari right was conferred on the following categories of tenants:

a. Certain intermediaries in respect to their *sir* or *khudkasht* rights;
b. Permanent lessees in Oudh with respect to land in their personal cultivation or held by them as a grove.
c. Fixed-rate tenants or rent-free grantees.
d. 1. Occupancy tenants; 2. Hereditary tenants; 3. Tenants of *Patta Dawami* or *Istamarari sir* land. Only such tenants became bhumidhars who possessed the right to transfer their holdings by sale.
e. All such sirdars who paid ten times their rent in the Zamindari Abolition Fund in a lump sum or twelve times the rent if paid in instalments. The *Adhivasis* also possess the right to become bhumidhars with certain restrictions which have been detailed in the Act.

A bhumidhar can use his land for any purpose of agriculture, industrial or building and can make whatever improvements he likes. Even if the land was originally used for some purpose other than agriculture, horticulture or animal husbandry including pisciculture and poultry farming, it can now be used for agricultural purposes. But in all such cases, the bhumidhar would have to obtain the permission of the Collector of the district.

A bhumidhar has a permanent heritable and transferable right in his land. But no transfer can be made to a person who together with his family already holds more than 30 acres in Uttar Pradesh. Moreover, no mortgage of land can be made where possession of the mortgaged land is transferred to the mortgagee as security for the money advanced. No sub-letting of the land by a bhumidhar is allowed except where a bhumidhar is a disabled person, an unmarried woman or a widow, a minor, a lunatic or an idiot, a person physically infirm or in the military, naval or air force of the

Indian Dominion or under detention or imprisonment.[1] The restriction on the right of sub-letting has been imposed in order that the peasant himself may cultivate the land and absentee landlordism in a disguised form may not arise again.

Growth of Bhumidhari Rights

With a view to giving immediate effect to the provisions of bhumidhari rights, the U.P. Agricultural Tenants (Acquisition of Privileges) Act, 1949 was passed in July, 1949. The Act provided that an ex-proprietary, occupancy or hereditary tenant or a tenant holding land on special terms in Oudh could acquire bhumidhari rights on payment of ten times his rent to the State Government and secure complete immunity from ejectment and be entitled to a reduction of his rent by half with effect from the date on which the next instalment of rent fell due. The above measure was a sound investment for the tenant as his revenue demand was reduced by half for a period of forty years. In effect, he gained the substance of bhumidhari rights immediately on receipt of the declaration and became entitled to the status of a bhumidhari simultaneously with the abolition of zamindari. The Zamindari Abolition Fund was started in 1949 and more than Rs. 34 crores have been contributed by over 40,000 tenants who have acquired bhumidhari rights.

Sirdar

A little lower than the bhumidhar is the sirdar. The following are some of the classes of the tenants who became sirdars under the Act:

(1) tenants holding on special terms in Oudh; (2) ex-proprietary tenants; (3) occupancy tenants; (4) hereditary tenants; (5) all such persons who held land on *Patta Dawami* and *Istamarari*, (6) grantees at a favourable rate of rent; (7) a grove-holder.

A sirdar cannot use his land for industrial or building purposes as a bhumidhar can. In fact, he cannot use his land

[1] *Sajhedari* (i.e. cultivation in partnership with another person who assists or participates with the landholder in actual performance of agricultural occupations) is not considered to be letting.

for any purpose other than that allied with agriculture, horticulture or animal husbandry including pisciculture and poultry farming. Further, as in the case of a bhumidhar, a sirdar cannot let out his land except when he is disabled, but can enter into *sajhedari.* The principal difference between him and the bhumidhar is that unlike the latter, he cannot transfer his land under any circumstances. But he possesses a permanent and heritable interest in his heritable holding.

Asami

The following are the classes of the tenants who became asami under the Act (i) non-occupancy tenants of intermediary's grove-land; (ii) a sub-tenant of the grove-land, (iii) a non-occupancy tenant of pasture-land or land covered by water used for growing *Singharas;* (iv) every person admitted legally by a bhumidhar or sirdar as a lessee of his holding, (v) an allottee of sir and khudkasht land allotted by the sir and khudkasht holder in lieu of maintenance allowance.

An asami has the right of exclusive possession of all land in his holding and can use such land for any purpose connected with agriculture, horticulture or animal husbandry. The asami is allowed to make an improvement which is not detrimental to any other land in any holding.

An asami is entitled to get compensation for improvements made with the written consent of the landholder or *gaon sabha,* if he is ejected from his holding or wrongfully deprived of his possession by the *gaon sabha* or landholder or when he vacates the holding on the expiry of his lease.

The asami is the lowest class of tenant who is not entitled to transfer his holding and cannot get it partitioned as a bhumidhar and sirdar can do. An asami can be ejected on some of the following grounds such as:

(1) for having a decree of arrears of rent against him;
(2) when agricultural crops can no longer be cultivated on the land;
(3) where the right of subsistence allowance ceases to exist;

(4) where the mortgage has been satisfied;
(5) if the landholder wants to cultivate the land himself, or on the expiry of the fixed terms of the lease.

Nevertheless, even the asami has been given important land rights under the Act and his status as a tenant is on a par with a hereditary tenant under the previous Tenancy Act.

The Act has considerably simplified the complicated pattern of land tenure and defined more clearly the rights, privileges and liabilities of the different classes of the cultivators. Broadly speaking, all persons continue to be in possession of the land which they were cultivating on the date of vesting. The Act in no way interfered with their actual possession but made the land-tenure system simple. The new classes of cultivators possess, more or less, the rights of security of tenure, fair rent and freedom to cultivate the land. The right of security of tenure has increased their interest in land and agricultural productivity is bound to increase in future.

In order to check the possibility of concentration of land in the hands of a few persons, it has been provided for in the Act that no one is allowed to purchase land if the area of his holding thereby exceeds 30 acres. The Act makes it obligatory for the peasants to cultivate the land themselves, for if land is not cultivated by a sirdar or an asami for two consecutive agricultural years, it is considered to be abandoned land and passes over to the *gaon samaj*.

All the landless people residing in a village have become full owners of their houses, house sites and appurtenant land and their wells and trees. Landless people are given first preference in allotment of vacant land by the *gaon samaj*.

§ 3. *REVISION OF LAND POLICY*

Incidence of Land Revenue

The incidence of land revenue as a proportion of total tax revenue has been very much reduced during recent times. Land tax was the mainstay of state revenues throughout the Mughal rule and the early part of British rule. The proportion of the land tax to the total revenue (both Central and Provincial States) declined from about two-thirds in the

first half of the nineteenth century to one-third in the beginning of the twentieth century. It was about 16 per cent in 1938-39 and just after the abolition of the zamindari (1953-54) it was only 8.6 per cent. The receipts from land revenue as a proportion of total revenue (Central and States) in some of the years are given below:

Receipts from land revenue as a proportion of total revenue
(Centre and States)

1793-94	69.0 per cent
1808-09	61.1 ,, ,,
1818-19	73.1 ,, ,,
1839-40	70.6 ,, ,,
1950-51	66.5 ,, ,,
1871-72	42.8 ,, ,,
1881-82	35.5 ,, ,,
1891-92	36.5 ,, ,,
1901-02	33.9 ,, ,,
1911-12	31.3 ,, ,,
1938-39	16.1 ,, ,,
1953-54	8.6 ,, ,,

This marked decrease in the importance of land revenue has primarily been due to the growth and importance of new forms of taxes, both Central and State, such as income-tax, customs, central excise duties and sales tax. Nevertheless, it is significant to point out that in spite of continuous growth in the area under cultivation, spread of railways, irrigation facilities and cultivation on a large scale of commercial crops there has been a reduction in the burden of revenue. This progressive decline in the receipt from land revenue can perhaps be better illustrated if we compare the share of land revenue to the total tax revenue of Part A States (the former Provinces) during the period 1922-23 to 1953-54, as given in the Table on the next page.

With the abolition of zamindari and jagir it has been estimated that the additional land revenue may be Rs. 6.28 from jagirs and Rs. 22.91 crores from zamindaris.

Revision of Land Policy

In Section II a brief account of the recent land reforms has been given. Little or no attempt has been made as

Share of land revenue in total tax revenue of Part A States
(formerly Provinces)
(In lakhs)

Year ending March	Total tax revenue (excluding shared taxes	Land revenue	Col. 3 as percentage of Col. 2
1	2	3	4
1922	62,80	34,39	54.8
1927	68,55	34,44	50.2
1932	60,31	32,61	54.1
1937	59,85	31,67	52.9
1942	60,99	27,70	45.4
1947	1,33,28	30,96	23.2
1952	1,62,65	33,05	20.3
1954	1,86,59	49,64	26.6

Notes: 1. The figures up to 1937 include Burma.
2. The figures from 1948 relate to Part A States in the Indian Union.

yet to reform or revise the land-revenue system of the country. The result has been that the land-revenue system of the nineteenth century, with minor changes still prevails in most parts of the country. Indeed, in most of the States the revenue demand which was fixed under the survey and Settlement operations completed at the close of the nineteenth century is still in force. These Settlements were not revised either on account of the depression of 1929 or World War II. The situation has become even more anomalous as with the integration of the princely States, huge areas have been incorporated in the States where the revenue demand was based on an empirical basis. Similarly, in the case of the permanently settled areas survey and Settlement operations were not carried out. Above all, the impact of the changes in agricultural prices has not been taken into account in the revenue demand at all. The result is that land revenue today presents a picture of utter confusion in the tax system of the country. The confusion has been worse confounded as the administrative machinery which has been set up to reform

land revenue has neither the training nor the experience to face the enormous responsibilities which have come after the abolition of zamindari.

It is not possible to discuss here in any detail the future pattern of land-revenue policy for the country as a whole. We will state briefly a few fundamental issues which may be kept in view in evolving a suitable land system in the fast changing tax system of the country. For the sake of brevity the issues are categorically stated as follows:

1. It is impossible to evolve a uniform pattern of land-revenue system for the country as a whole. In many matters of detail there is bound to remain a diversity in the revenue features of the different States and even in the same State. Nevertheless, it is desirable to attain a minimum degree of uniformity in basic matters like initial fixation of assessment; revision of assessment; limits of increase or decrease of revenue demand; the apportionment of land revenue to local bodies; and the place of agricultural income-tax *vis-à-vis* land revenue.

2. A detailed survey and Settlement is indispensable and should immediately be undertaken in all the States. The principles of Settlement as were adopted during British rule, with slight adjustments, should be uniformly adopted for all the areas in each State. The period for completing the Settlement operations should be reduced to a minimum possible length of time. Besides, a permanent Settlement machinery should be kept in each State to revise periodically the Settlement operations, say, in every ten years.

3. Meanwhile, the land-revenue demand as it exists today should be supplemented by surcharges which should take into consideration some of these factors:

(i) Changes in price-level since the last Settlement was over or the *ad hoc* demand was fixed; (ii) effect on holdings above a particular size or nature of crops, such as cotton, oilseeds, tobacco or sugar-cane; (iii) measures which have increased security of crops; (iv) improved means of transport etc. etc. Broadly speaking the following standard formula may be taken into consideration in fixing the surcharges:

Settlement Period[1]	Average price level price index 100 1873-1900	Proposed increase (surcharge) in the present assessment demand
1880-99	124	33⅓ per cent
1900-19	198	15 per cent
1900-31	242	10 per cent
1940—onward	697	6¼ per cent

[1] Most of the First Settlements were completed by the close of the nineteenth century.

4. Besides land revenue, a local cess up to 12½ per cent should be levied, the proceeds of which should be earmarked for local purposes.

5. From land revenue an amount, not less than 25 per cent should be allocated to local bodies (village panchayats etc.) for purposes of local improvement.

6. The present machinery for collecting land revenue should be gradually supplemented by that of village panchayats or other local authorities.

7. In order that the survey and Settlement operations may be carried out in a scientific manner on an all-India basis, a Land-Revenue Training School should be started to train civil servants for revenue work.

8. Finally a Land Commission should be appointed in each State to study local land problems and evolve principles in the light of which the survey and Settlement operations may be carried on in future.

The one outstanding fact which emerges from the account in the foregoing pages is that the present land-revenue system, in spite of land reforms, is out of tune with the recent significant changes in the tax policy of the country. The three urgent reforms in land-revenue policy are (i) its rationalization and making the Settlement operations up to date; (ii) increasing the revenue demand in view of the increase in taxation in other fields of economic activities; (iii) co-ordinating the incidence of rental demand with the changes in the level of prices.

The Leading Principles of Assessment

It may perhaps be useful at this stage to state briefly the leading principles of assessment which should, more or less, be followed by all the States in their Settlement operations.

The two important terms used in the Settlement of land-revenue are, *assessment* and *Settlement.* By assessment is meant the process by which the revenue demand of a particular area, holding or village is calculated. By Settlement is meant the contract by which an individual or a body of persons is singly or jointly responsible for the payment of land revenue assessed on a particular area. But Settlement is often used in a broad sense and covers all the processes necessary for the settlement of land revenue, e.g. preparation of a survey map, 'record of operations', 'soil classification', 'record of rights' and 'assessment proper'. The results of these operations are published in a Settlement Report.

Settlement operations may broadly be divided into four important stages, viz. (i) the preparation of a survey map and record of rights; (ii) soil classification; (iii) an assessment proper; and (iv) the presentation of the Settlement Report to the Board of Revenue and the Legislative Assembly.

The preparation of a survey map is the first step in Settlements. Usually each village has a separate map. The map is prepared by some trained assistants deputed for the work. In some recent Settlements in Uttar Pradesh, photographic maps were prepared by an aerial survey.

After the field map is ready a 'record of rights' should be prepared. The records should consist of two parts. In the first part should be recorded: (a) the names of the proprietors; (b) the names of the tenants who are holding the land; (c) the class to which each tenant belongs; (d) the sources of irrigation; (e) the nature of the land; and (f) the crops that are raised on it. The second record should be a *register of holdings.* In this should be recorded against the name of each tenant, the serial number of the fields held by him, their areas and the annual rent.

These records are very important and even when the Settlement is over they should be kept up to date and revised annually by the Revenue Department.

The third stage is soil classification. The basis of subdivision of soil is various, the most important divisions are based on: (a) the nature of the soil e.g., loam, clay etc., (b) the nature of cropping; double-cropping (*dofasli*) or single-cropping (*ekfasli*); (c) the distance from the village i.e., village land, middle zone, and outer zone; and (d) means of irrigation i.e., irrigated by canals, wells or rainfall. The soil classification in each case depends upon local conditions. It is an important factor in the actual process of assessment.

The fourth stage is the most important one. Most of the recent assessments took into consideration not the gross but the net produce. The difference in Settlements in various States would depend upon the meaning given to the words 'net assets' and the method adopted to ascertain the net assets. In Northern India, the net assets are usually taken to mean the rent, whether real or hypothetical (by which latter term is meant that portion of the gross produce which would be taken by the State if the land were equally rented).[1]

[1] Under British rule the Settlement Operations were very carefully carried out in Uttar Pradesh. I take the liberty of quoting at length the following paragraph from the *I.C.S.* by Sir Edward Blunt describing the Settlement Operations in Uttar Pradesh:

In the United Provinces, the first step is to assign to each soil a value, which is obtained by consideration of relevant date, for instance, the rents actually recorded, as paid for each class of soil; crop-cutting experiments, which consist in measuring out exactly a given area, and ascertaining the yield of that area; a comparison of the value of the crops actually grown in each soil; and also generally inquiries from the cultivators themselves. The second step is to arrange the village in circles, which are homogeneous in respect of such characteristics as climate, communications and agricultural conditions. The recorded rent-rolls of the village in a circle are then examined, and all fraudulent, inadequate, excessive and other abnormal rents are excluded. The incidence of the remaining rents is then calculated for each class of soil, and a set of standard rates for each circle is worked out. These 'circle' rates are then compared for each village with the recorded rent, in other words, the rent-roll as it is, is compared with the rent-roll as it ought to be. If, after making allowance for any local peculiarities, the two approximate, then the recorded rent-roll will be accepted as the basis of assessment. If the two diverge greatly without any ascertainable justification then the assessment is based on the valuation at circle rates. To the rent-roll or rental valuation, is added a valuation at circle rates of unrented lands, which usually consist of the landlord's own holding, from which a deduction, usually 25 per cent, is made to allow for the landlord's cost of production. To the total of these two figures are added any other assessable items, in the nature of manorial dues, and the total forms the net assets of the village.

After the Settlement Operations are over the Settlement Officer writes out the Report. The Report is submitted to the Board of Revenue and the Legislative Council. The Legislative Council is given an opportunity to discuss it. Ordinarily, minor alterations are proposed which are usually adopted and the Report is accepted.

The policy of the Government during the twentieth century has been to prescribe moderation in revenue enhancements and greater elasticity in its collection. Historically, the revenue system of the Government owes its origin to the Mughal times. It was by slow degrees, and not without mistakes, that it could be given a reorientation agreeing with the changed economic conditions. Indeed, no tax in India is more difficult to work, without causing discontent and hardship, than land revenue. Lord Curzon had pointed out that logical completeness or simplicity cannot be expected in revenue systems born amid such surroundings, applied to such manifold conditions and to so heterogeneous a population. The principles of assessment must, therefore, depend upon considerations of practical expediency, rather than be regulated by fixed laws or shaped by arithmetical standards.

Assessments elude theoretical treatment. In no field of taxation is the personality of the tax officer more reflected than in land revenue. The true function of the Government is to lay down broad and generous principles for the guidance of its officers, with becoming regard for the traditions of the State and the circumstances of the locality, and to prescribe moderation in enhancement and sympathy in collection. Above all, it is its duty to exercise discrimination in the choice of the agents whom it employs for this most responsible of tasks. It is thus and thus alone that the principles of assessment which form the basis of land revenue can have a human touch in them. Let us hope that in free India land revenue will be an elastic source of revenue and it will be realized with little hardship and discontent.

XII

INCOME-TAX

§ 1. *INCOME-TAX*

Introductory

In the field of direct taxation in India there are at least six important taxes, viz. (i) Income-tax; (ii) Estate Duties; and (iii) Wealth Tax; (iv) Expenditure Tax; (v) Gift Tax and (vi) Land Revenue. During the two World Wars the Excess Profit Tax was imposed. With the discontinuance of the Excess Profit Tax in 1946 a Business Profit Tax was levied on profits earned by companies during the period April 1, 1946 to March 31, 1949. The main features of income-tax will be described in this chapter.

Income-tax in India comprises the following taxes:

(i) Income-tax proper;

(ii) Super-tax—an additional duty on income-tax charged above a specified limit of income;

(iii) Super-tax on companies—popularly known as Corporation tax; and

(iv) Surcharge—additional emergency duty levied occasionally on (i) and (ii) above.

Income-tax under the Act is levied annually for each financial year commencing on April 1 and ending on March 31 following.[1] The tax is levied at the rates sanctioned by Parliament in the Annual Finance Act.

Income-tax in its modern form was first introduced in India in 1860 by James Wilson. During the period 1860-86, a series of experiments was made in the field of direct taxation and income-tax was, more or less, on trial all through this period. In 1886 the first systematic legislation on income-tax was enacted and from that year onwards income-tax came to occupy a permanent place in the Indian tax-structure. During the past 75 years the structure of tax has undergone a series of

[1] The Financial year is known as the Income-tax year, Fiscal year or Assessment year.

important changes; the principal factors responsible for the changes have been the need for additional revenues, the changing economic conditions of the country, judicial decisions, and the desire of the Government to bring the largest volume of income within the scope of taxation. It is important to point out that there are three important characteristics of Indian income-tax which sharply distinguish it from the tax systems of other countries, viz. (i) the separate treatment of agricultural income; (ii) the 'base' of taxable income in the case of Hindu undivided families; and (iii) the taxation of corporate income. It may also be pointed out that income-tax in India is levied by the Government of India alone; the State Governments have no right to levy it. This has been done to avoid conflict in tax jurisdiction. The State Governments, however, are vitally interested in its yield, as a part of it is divided amongst them on the recommendations of the Finance Commission. In order to appreciate its role in the tax-structure it may perhaps be desirable to review its main features under the following heads:

i. Basis of liability;
ii. Taxation of agricultural income;
iii. Problems of evasion and avoidance of tax; and
iv. Growth of income-tax receipts.

Basis of Liability

A study of the basis of liability divides itself into a study of:

i. Basis of liability to tax, i.e. taxation of residents and non-residents; and

ii. Net income, i.e. income-tax should not fall on capital or any element necessary to cost. The problems of deductions and allowances from gross income in order to arrive at net income fall within the concept of net income.

While the former is a matter of purely legal interpretation based upon the desire of the tax authority to tax the income of non-residents, the latter raises issues of fundamental importance in the field of Public Finance, especially relating to capital formation and the desire to work and save.

	Status of assessee		
	Resident and ordinarily resident	Resident but not ordinarily resident	Non-resident
1. Income accruing, arising or received, or deemed to accrue, arise or be received in the taxable territories.	Taxable[1]	Taxable[1]	Taxable[2]
2. Income accruing or arising outside the taxable territories (subject to a deduction of unremitted income up to a maximum of Rs. 4,500)	Taxable[3]	Taxable if it is derived[4] from a business controlled in, or a profession or vocation set up in India	Not taxable
3. Remittances received out of income which accrued outside India after 1-4-1933 and before the beginning of the previous year.	Taxable, unless[5] already taxed in the year of accrual.	Taxable unless already taxed in the year of accrual	Not taxable

[1] Section 4(1) (*a*) and (*b*) of the Indian Income-tax Act.
[2] Section 4(1) (*a*) and (*c*), ibid.
[3] Section 4(1) (*b*) (*ii*) and third proviso, ibid.
[4] Section 4(1) (*b*) (*ii*) and second proviso, ibid.
[5] Section 4(1) (*b*) (*iii*), ibid.

Concept of Resident

The Income-tax Act, 1886, levied a tax on income accruing or arising to or received by a non-resident through an agent in India. The terms 'resident' and 'non-resident' were not defined in the Act and were largely interpreted on the lines of the decisions of the British courts of law. The foreign income of a 'resident' was brought to charge on the 'remittance' basis for the first time in 1922 in respect of income accruing and arising outside British India under the head 'business'. With effect from April 1, 1953, the basis of taxation was widened to apply to income from all sources. The most important change came in 1939 when the entire income of a resident, whether accruing in British India or outside became chargeable to tax. The law relating to the basis of liability to tax was mostly influenced by (i) the desire to bring more income within the orbit of taxation; (ii) considerations of equity between different persons; (iii) preferential treatment given to the European business community and English civil servants; and (iv) the existence of the British-Indian Provinces and the Indian States which resulted in the migration of capital to the latter to escape income-tax.

The present position regarding the basis of liability to tax as defined in sections 4, 4A and 4B of the Income-tax Act is broadly indicated in the statement on the preceding page.

With the integration of the princely States in the Indian Union the problem of non-residents has been put on a uniform basis for the country as a whole. But the special problems arising out of huge capital importation for financing the Plans perhaps need a review of the present law relating to the basis of liability in the case of international investments.[1]

[1] The *Taxation Enquiry Commission* recommended the following scheme for taxation of foreign income:

(*i*) the foreign income of a resident should continue to be taxed as hitherto in the year of accrual;

(*ii*) unilateral relief should also continue to be extended to such income if it has suffered tax abroad;

(*iii*) in the year in which the assessee remits the earnings so taxed to India, he should be given a refund of the actual tax borne by him. This will be regulated as follows:

(*a*) there will be no refund if the Indian and foreign tax rates are the same;

(*b*) the refund will equal the difference between Indian and foreign rates if the former is higher; and

Concept of Income

Income is not adequately defined in the Act. Its connotation conforms, more or less, to the layman's conception of money or money's worth periodically received from a definite source. Broadly speaking it does not include capital receipts, nor does it include capital gains or gifts. For income-tax purposes the income is classified under the following heads or sources:

1. Salary;
2. Interest on securities;
3. Income from property;
4. Profits and gains of business, profession or vocation;
5. Income from any other source;
6. Capital gains arising during the period April 1, 1946 to March 31, 1948.

Rates of Income-tax

The rates at which the tax is levied on persons are fixed by the Annual Finance Act. The rate of tax, the exemption limit and the relief admissible differ according to the status of the assessee, i.e. whether the assessee is an Individual, Hindu Undivided Family, Firm, Local Authority, Company or other Association of Persons. A minimum exemption limit below which the tax is not charged is also fixed for each year under the Finance Act. For the year 1958-59 the minimum exemption limit is Rs. 3,000 (married individual) for all assessees except Company and Local Authority. In the case of Hindu undivided families which satisfy the conditions mentioned in the Finance Act the minimum is Rs. 6,000.

The rates of income-tax in the case of every individual who is married and every Hindu undivided family whose total income does not exceed Rs. 20,000 are given on the next page.

Problems of Graduation

An analysis of the rate structure applicable to personal income under the Income-tax Act points out that the concept

(*c*) no refund will be involved if the Indian rate is lower than the foreign rate. Transitional provisions would be necessary in respect of income which had accrued before the system of full unilateral relief came into force, or in respect of which double income-tax relief had been granted on some other basis.

Rates of Income-tax on Total Income, not exceeding Rs. 20,000, of Married Individual & Hindu undivided family*

		1	2	3	
		Where the individual has no child wholly or mainly dependent on him or where the Hindu undivided family has no minor coparcener	Where the individual has one child wholly or mainly dependent on him or where the Hindu undivided family has one minor coparcener	Where the individual has more than one child wholly or mainly dependent on him or where the Hindu undivided family has more than one minor coparcener	
		Rs.	Rs.	Rs.	
1.	On the first	3,000 of total income	3,300 of total income	3,600 of total income	Nil
2.	On the next	2,000 ,,	1,700 ,,	1,400 ,,	3%
3.	On the next	2,500 ,,	2,500 ,,	2,500 ,,	6%
4.	On the next	2,500 ,,	2,500 ,,	2,500 ,,	9%
5.	On the next	2,500 ,,	2,500 ,,	2,500 ,,	11%
6.	On the next	2,500 ,,	2,500 ,,	2,500 ,,	14%
7.	On the next	5,000 ,,	5,000 ,,	5,000 ,,	18%

* See *Income-Tax for the Layman*, 1958, p. 43.

of net income has to a large extent been kept in view in basing the tax liability of an individual tax-payer. Some of the methods adopted in reducing gross income to net taxable income are: graduation in the rate of tax; the introduction of the slab system; the exemption limits; differentiation between earned and unearned income; and special treatment in rate-structure in the case of the Hindu undivided family. Under the Act of 1886, income-tax was levied on income from four different classes; graduation in the rates of income-tax which existed before 1916, was only nominal, as a standard rate of five pies in a rupee was applicable to all incomes above Rs. 2,000. Under the financial strain caused by the First World War, graduation in the real sense was introduced in 1916 when eight different rates of tax were laid down for income in different brackets. These rates were frequently changed in between the two Wars as the financial needs of the Government demanded.

As a result of the recommendations of the Income-Tax Enquiry Committee, 1936, a change-over in income-tax from the 'step' system to the 'slab' system was introduced in 1939.[1] The slab system introduced a greater element of equity in income-tax and widened the concept of net income.

There have been frequent changes in the rate structure ever since 1939, both in income-tax and super-tax rates. Since 1939, in order to have a minimum income exempt from taxation, the law introduced the practice of a tax-free slice of Rs. 1,500. The slabs of income have remained the same ever since 1939 and the changes have been confined to a variation in the rates applicable to the various slabs. In the case of super-tax, however, there have been changes both in the slabs as well as in the rates in each slab.

With a view to keeping the incidence of tax low on lower income brackets, the Indian income-tax has always exempted a certain amount of income from taxation. During the period 1922 to 1947 (except for a few years under War conditions) income below Rs. 2,000 was exempt from taxation. Since 1947 the exemption limit was gradually raised to Rs. 4,200 for individuals and twice the amount for the Hindu undivided family. It is now Rs. 3,000 for married individuals. Exemptions and abatements, moderate no doubt, have also been granted to adjust the incidence of income-tax and also to encourage savings and investment. Thus, life insurance premia paid by an assessee on a policy of his own life or that of his wife have been exempted since 1886; similarly exemption has also been granted since 1918 to Provident Fund governed by the Providend Fund Acts: the total amount of exemption in respect of both the above items is, however, subject to one-sixth of the total income or a monetary limit of Rs. 6,000 (Rs. 12,000 for the Hindu undivided family.)[2]

The concept of income has further been taken into account by the introduction of the principle of differentiation between earned and unearned income. This differentiation has been effected in two different ways. Firstly, the assessee is allowed

[1] Under the 'step' system all assessees in a particular income bracket pay the same effective rate on every rupee of their income; under the 'slab' system the tax is calculated on each slab separately and then added up.

[2] Since 1939.

to exclude from his income a fixed proportion subject to a maximum limit. This scheme was introduced in 1945 and has continued ever since with changes in the amount granted from time to time.[1] For super-tax purposes the method of differentiation adopted is to levy the tax on the earned income at lower rates than on the unearned income. This differentiation, however, was short-lived and at present the rates of super-tax on earned and unearned incomes are uniform.

An important practice in the income-tax laws of some countries (notably the U.S.A.) is to grant huge abatements in respect of voluntary donations for religious, social, or charitable purposes. The abatement under the Indian law is at the average rate of income-tax and super-tax applicable to an assessee (but not exceeding a total amount of 50 nP. in the rupee); it applies to donations of not less than Rs. 250 or not more than one lakh in a year and not exceeding 5 per cent of the assessee's income.[2] ✓

One important defect of Indian income-tax is that it does not take into account, what Lord Stamp called, the domestic circumstances of a tax-payer. Perhaps the role of liberal family allowances, which is an important feature in the tax-structure of many countries, is sought to be filled in India by a tax-free slab available to an assessee. The slab is supposed to represent the minimum subsistence needs of an average family. An allowance of Rs. 2,000 is granted to a married man; which again has been further confined to people who do not pay super-tax.

Excess Profit Tax

In order to tax unusual profits made under wartime economy an excess profit duty was levied for the first time in India in 1919 (when the First World War, however, was over). It remained in force for one year only. The Excess Profit Tax was introduced, however, early in the Second World War with effect from September 1, 1940, and remained in force till March 31, 1946. It applied to profits made by all businesses and professions except (i) life insurance business;

[1] The present exemption is Rs. 3,000 in the case of a married individual.
[2] There is also a child allowance; the exemption limit is Rs. 3,400 in the case of one child and Rs. 3,600 in the case of more than one child.

(ii) professions when the earnings of profits depended mainly on personal qualifications (iii) profits assessed only on the remittance basis and (iv) profits arising in Indian States after March 31, 1942. For each accounting year falling within the above years a standard profit was calculated. For the profits during the period between September 1, 1939 to March 31, 1941 excess profit was levied at the rate of 50 per cent on the excess over standard profit, while a rate of 66⅔ per cent was applied on such excess during the period April 1, 1941 to March 31, 1946. In Table L are given the demand and collection of excess profit tax during the period 1940-41 to 1950-51.

TABLE L

DEMAND AND COLLECTION OF EXCESS PROFIT TAX FROM 1940-41 TO 1950-51

(In lakhs of rupees)

Year ending			Excess profit tax charged during the year	Collections made during the year
31.3.1941	..	..	56	54
31.3.1942	..	..	9,22	7,85
31.3.1943	..	..	26,21	20,78
31.3.1944	..	..	68,07	60,30
31.3.1945	..	..	1,14,00	1,02,15
31.3.1946	..	..	1,01,34	88,31
31.3.1947	..	..	94,46	75,76
31.3.1948	..	..	37,09	21,19
31.3.1949	..	..	35,30	28,49
31.3.1950	..	..	13,22	7,51
31.3.1951	..	..	13,27	8,12

Source: *Report of the Taxation Enquiry Commission*, Vol. II, p. 13.
The tax was abolished in 1946 but the collections continued till 1950-51.

Business Profit Tax

With the abolition of the Excess Profit Tax in 1946 a Business Profit Tax calculated in a similar manner was levied on profits earned by business during the period April 1, 1946 to March 31, 1949.[1] The Business Profit Tax was imposed as an

[1] See *Report of the Taxation Enquiry Commission*, Vol. II, p. 14.

anti-inflationary measure. The type of business and profit subject to this tax was the same as for the excess profit tax, only the excess of the profit over a standard figure called the 'abatement' being chargeable to the tax. The abatement for companies was six per cent of the working capital, subject to a minimum of Rs. 1 lakh per annum up to March 31, 1947 and Rs. 2 lakhs per annum subsequently. For other assessees the abatement was Rs. 1 lakh per annum up to March 31, 1947 and Rs. 2 lakhs per annum subsequently. The tax was levied at the rate of $16\frac{2}{3}$ per cent of the amount of excess profits over the abatement up to March 31, 1947 and ten per cent thereafter.

Growth of Income-tax Receipts

We have now briefly surveyed the main features of income-tax in India. In concluding this section we give a few statistics relating to net collections, the number of assessees and the total income assessed.

It is interesting to note that net collection of income-tax rose from Rs. 1.37 crores in 1886 to Rs. 191.3 crores in 1944-45. The net collection was very poor in 1915 when it remained between Rs. 2 crores to Rs. 3 crores. With the introduction of graduation, a change in the concept of total income and the levy of super-tax (1916-18), the net collections rose to Rs. 22 crores in 1919-20. During the period 1930-39, the collections ranged between Rs. 15 to 18 crores. It was only after the amendment of the law in 1939 and the introduction of the slab system that the net collection rose to Rs. 26 crores in 1940-41. There was an abnormal rise in the net collection as a result of the Second World War. The net collections of income-tax and super-tax from 1948-49 to 1957-58 are given in Table LI.

The brief account given therein is interesting in showing the growth in income-tax during the period 1886-1957 when it rose from a meagre figure of Rs. 1.37 crores to Rs. 208 crores in 1957-58. During recent years the principal factors which have contributed to the increase in its yield are: (i) the introduction of the slab system in 1939; (ii) the steep rise in the rates during the Second World War; (iii) the increase in taxable capacity as a result of the enormous economic develop-

TABLE LI

NET COLLECTIONS OF INCOME-TAX AND SUPER-TAX FROM 1948-49 TO 1957-58

(In crores of rupees)

1948-49	183
1949-50	160
1950-51	173
1951-52	188
1952-53	185
1953-54	163
1954-55	160
1955-56	168
1956-57	189
1957-58	208 (Revised Budget)

ment which took place during the period; and, (iv) finally the enlargement of the basis of tax liability as a result of the amendment introduced by the 1939 income-tax legislation.

TABLE LII

THE NUMBER OF ASSESSEES ACCORDING TO INCOME GROUPS SINCE 1948-49

	Assessees with annual business income of				Salaried assessees, cases involving loss etc.	Total
	More than Rs. 25,000	Between Rs. 10,000 & 25,000	Between Rs. 5,000 & 10,000	Less than Rs. 5,000		
1	2	3	4	5	6	7
1948-49	36,598	59,352	92,130	1,42,769	1,90,996	5,21,845[1]
1949-50	39,242	61,090	87,832	1,42,500	2,15,852	5,46,516[1]
1950-51	43,830	75,526	1,17,063	1,61,555	3,06,257	7,04,231[1]
1951-52	45,761	81,229	1,31,312	1,55,717	3,82,297	7,96,316
1952-53	51,795	96,173	1,46,635	1,61,030	4,44,773	9,00,406
Percentage Increase between 1948-49 & 1952-53	40	39	59	13	133	42

[1] Contains assessments re-opened under section 34 for which no separate record was kept before 1951-52.

Coming to the number of assessees, it was 2,43,000 in 1904-5 when the exemption limit was Rs. 1,000; when the exemption limit was raised to Rs. 2,000 in 1922-23 it was 2,73,311. On the eve of the Second World War in 1939 it was 2,85,940. Soon after the War had started in 1940-41 the number of assessees was 3,63,532. It was 4,47,484 in 1946-47, immediately before the partition of the country. The preceding table gives the number of assessees according to income groups since 1948-49.

Total Income Assessed

The total income assessed in various years is given below:

1886-87	33
1903-04	53
1922-23	236
1937-38	174
1940-41	205
1943-44	406
1946-47	483
1948-49	571
1949-50	587
1950-51	575
1951-52	783
1952-53	710

Problems of Evasion

One of the most important facts which emerges out of the above statistical account is that only a small percentage of the national income is brought under taxation and consequently the number of assessees is very small. The figures point out that there may be a considerable volume of evasion and avoidance of taxation. It is not possible to estimate accurately the extent of the leakage of revenue through evasion. Nevertheless, the information collected in connection with the Disclosure Drive is extremely significant in pointing out that income as originally included in the returns sent to the Income-Tax Department by the assessees who made disclosures was grossly underrated; the differences between the income as originally returned and that disclosed later to the Department, being, on the average, as much as 60 per

cent. The existence of evasion on such a large scale defeats the very purpose of taxation, makes the tax-structure most inequitable, and places a heavy burden on honest tax-payers. The state loses a very large amount of revenue and naturally introduces other taxes to fill in the revenue gap to meet the growing demands of expenditure. It may not be possible to check evasion immediately; however, the adoption of some of the following methods, as suggested by the Taxation Inquiry Commission, may reduce the volume of evasion.

(*i*) Administrative measures adopted for tracing 'new' assessees (i.e. those who have taxable incomes but fail to send in returns) and for verifying the accuracy of the returns submitted by existing assessees, by:

- (*a*) external survey;
- (*b*) exchange of information collected from the records of existing assessees available in the Income-Tax Department;
- (*c*) collection of information obtained from outside sources (including informers);

(*ii*) special arrangements for dealing with cases of substantial evasion;

(*iii*) legal provisions for enforcing 'back duty', i.e. section 34 of the Income-Tax Act, etc.;

(*iv*) public censure as a remedy for evasion;

(*v*) proper representation in income-tax proceedings;

(*vi*) strict enforcement of collections; and

(*vii*) voluntary disclosure of concealments.

With the introduction of the Wealth and Expenditure Taxes the volume of evasion may be much reduced as they will act as checks and balances to strengthen the administrative machinery in enforcing the income-tax law and help the Department in ascertaining the income of the assessee.

Burden and Incidence of Income-Tax

In the foregoing pages an attempt has been made to give a broad outline of the main features of Indian Income-Tax. It is often said that the Indian Income-Tax rates are heavy and burdensome as compared with the prevailing rates in other leading countries. It is argued in particular that many

Country	Categories of Income				
	1 Income from Agriculture	2 Capital gains and casual receipts	3 Lump-sum payments received as compensation for loss of office	4 Pension Annuities	5 Others
India	Exempt	Exempt	Exempt	Not exempt	1. Income for two years from any building erected between 1946 and 1954 exempt. 2. Interest, from Postal Deposits, Ten years Treasury Certificates, and National Savings Certificates.
U.S.A.	Not exempt	Not exempt	Not exempt	Not exempt; 3 per cent of aggregate premium paid to be deducted from an annuity.	....
U.K.	Not exempt	Exempt in the case of casual gains: exemption granted in each case on its own merit.	Exempt	Not exempt	....
Canada	Not exempt	Capital gains on sale of property, not exempt.	Not exempt	Not exempt. An allowance for capital element is made on annuities.	....

Source: *Income-Tax for the Layman*, 1953, p. 73.

of the reliefs available for dependents like wife and children in countries like the U.K. and the U.S.A., are not given under the Indian Income-Tax Act as a consequence of which the tax burden is heavy. In comparing the net burden of income-tax on an individual it is necessary to take into consideration the several types of receipts from which he derives his total income, e.g. income from business, from agriculture or from the sale of ancestral property. A tax system, which includes the receipts from all sources, imposes a heavier burden than the one which exempts one or more categories of such receipts. Hence the larger the number of exemptions the lighter the tax burden. An attempt has been made in the statement on the next page to state the exemptions in India and in some other countries.

The above statement is not exhaustive. Nevertheless, it points out the liberal exemptions under the Indian Income-Tax which go a long way to reduce the actual burden of the tax-payer in relation to the income enjoyed by him from all sources.

A comparison of the rates of taxation in India with some of the leading countries of the world points out that the Indian rates compare favourably with the general world-pattern. The rates on the lowest and highest slabs are given in the following table:

TABLE LIII

Country & Year			Rate of lowest slab Rs.	Rate %	Rate of highest slab Rate %		Rs.
India	(1952-53)	Up to	5,000	4.9	82.0	Over	150,000
Brazil	(1951-52)	,,	15,544	3.0	50.0	,,	777,200
S. Africa	(1950-51)	,,	13,300	6.2	62.9	,,	213,333
Egypt	(1951-52)	,,	20,625	8.0	70.0	,,	687,500
France	(1951-52)	,,	2,759	9.0	78.0	,,	82,750
Sweden	(1951-52)	,,	926	10.0	70.0	,,	185,185
U. K.	(1952-53)	,,	1,330	15.0	97.5	,,	200,000
Canada	(1950-51)	,,	4,580	15.0	80.0	,,	1,832,000
U. S. A.	(1951-52)	,,	9,540	20.4	91.0	,,	954,000
Japan	(1951-52)	,,	666	20.0	55.0	,,	13,333

Source: *Income-Tax for the Layman*, Central Board of Revenue, India, 1953, p. 71.

§ 2. *AGRICULTURAL INCOME-TAX*

One of the peculiarities of Indian income-tax is that the taxation of agricultural incomes does not come within its scope. During the period 1860-1935, except for two short periods of nine years in all (1860-65 and 1869-73), income from agriculture was exempt from general income-tax. This was mainly due to political reasons. It is not possible here to enter into the details of the controversy for this exemption; suffice it to state that the Indian Taxation Enquiry Committee (1925) recommended its imposition in the following words:

> 'There is no historical or theoretical justification for the continued exemption from income-tax of incomes derived from agriculture. There are, however, administrative and political objections to the removal of the exemption at the present time. There is ample justification for the proposal that incomes from agriculture should be taken into account for the purpose of determining the rate at which the tax on the other income of the same person should be assessed, if it should prove administratively feasible and practically worth while.'

However, the position remained unchanged till the coming of Provincial Autonomy, 1937, under which a separate Provincial income-tax on agricultural income was possible for the first time. Under the Constitution there are also two types of income-tax; a general income-tax on non-agricultural income and agricultural income-tax on agricultural income. (The former is divided between the Government of India and the States; while the latter is entirely a States' source of revenue.)

Receipts from the Tax

Bihar was the first State in India to levy the agricultural income-tax; similar Acts were passed later on in other States also. Before the reorganization of the States, agricultural income-tax was levied in the following twelve States:

1. Bihar
2. Assam
3. Bengal
4. Orissa
5. Uttar Pradesh
6. Hyderabad

7. Travancore-Cochin
8. Madras
9. Rajasthan
10. Coorg
11. Bhopal
12. Vindhya Pradesh

The nature and the incidents of the provisions of the Acts differ from State to State on account of the nature of the land tenure and the types of settlement. Thus in the permanently settled areas of Bengal, Bihar and Orissa the yield from the tax was rather small as the revenue derived from the permanent settlement was fixed. Madras restricted the tax to incomes from plantations. In the former princely States of Hyderabad and Travancore-Cochin, agricultural income along with non-agricultural income was taxable before the integration of those States in the Indian Union.

The receipts from agricultural income-tax in the different States were as given in the table below:

TABLE LIV

RECEIPTS FROM AGRICULTURAL INCOME-TAX

States	1940-41	1945-46	1950-51	1951-52	1952-53	1953-54	1954-55
Bihar ..	15	31	69	57	46	35	22
Assam ..	39	49	79	91	108	89	69
West Bengal			63	64	61	63	64
Orissa ..			10	13	7	8	8
Uttar Pradesh			138	100	71	58	36
Hyderabad				11	3	5	5
Travancore-Cochin			50	99	96	90	90
Madras ..							7
Coorg ..					14	15	10
Rajasthan (1.4.54)							15
Bhopal ..							2
Vindhya Pradesh					1	1	3

Concept of Agricultural Income

Under the Constitution, Article 366 states that agricultural income shall mean agricultural income as defined for the purpose of the enactment relating to Indian income-tax. Section 2 (2) of the Indian Income-Tax Acts, 1922 defines agricultural income as follows:

(*a*) any rent or revenue derived from land which is used for agricultural purposes and is either assessed to land revenue in the taxable territories or subject to a local rate assessed and collected by officers of the Government as such:

(*b*) any income derived from such land by:

(*i*) agriculture, or

(*ii*) the performance by a cultivator or receiver of rent-in-kind of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render the produce raised or received by him fit to be taken to market, or

(*iii*) the sale by a cultivator or receiver of rent-in-kind of the produce raised or received by him in respect of which no process has been performed other than a process of the nature described in sub-clause (*ii*);

(*c*) income derived from any building owned and occupied by the receiver of the rent or revenue of any such land, or occupied by the cultivator or the receiver of the rent-in-kind, of any land with respect to which, or the produce of which any operation mentioned in sub-clauses (*ii*) and (*iii*) of clause (*b*) is carried on: provided that the building is on or in the immediate vicinity of the land, and is a building which the receiver of the rent-in-kind by reason of his connection with the land requires as a dwelling house or as a store-house, or other outbuilding.

Though the definition is clear, questions have been raised occasionally whether particular incomes are agricultural or non-agricultural. Most of these disputed points have, however, been settled by judicial decisions. The following incomes also are now held to be agricultural incomes:

(*i*) income derived from letting out pasture land provided the animals pastured are agricultural animals;

(*ii*) amount paid by mortgagor-lessee to the mortgagee under usufructuary mortgage, whether or not the amount is or ought to be appropriated towards the principal or interest of the mortgage or to any other purpose;

(*iii*) *malikanas* payable to a proprietor in lieu of surrender of all his proprietary rights, to a transferee, which is payable whether or not the lands are used for agricultural purposes;

(*iv*) interest payable on arrears of rent, on the ground that it is not payable for use of the land but as compensation for delay in payment.

Incidence of the Tax

It is difficult to describe the incidence of agricultural income-tax Statewise. Broadly speaking, in all the States the tax is charged for each financial year on the total agricultural income of the previous year of every 'person', which includes an association of individuals, a Hindu undivided family, a firm or a company. The rates of the tax have been laid down in some of the Acts themselves; while in others, like the Indian Income-Tax Act, the rates are fixed annually under the annual financial Acts of the States. The Acts have also prescribed an exemption limit and have laid down that incomes below the limit shall not be taxable.

The exemption limit and the rates in all the States have been changed at different intervals. The exemption limit has been reduced under the pressure to realise large revenues. In some States agricultural incomes are also subject to super-tax. Under the Bihar Agricultural Income-Tax Act, 1938, the prescribed exemption limit was Rs. 5,000; the minimum tax was six pies in the rupee on incomes exceeding Rs. 5,000 and the maximum was 30 pies in the rupee on incomes exceeding Rs. 15 lakhs. In 1953-54 the exemption was reduced to Rs. 3,000; the minimum rate was 9 pies in the rupee and the maximum was 4 annas per rupee for incomes exceeding Rs. 15 lakhs. There was a surcharge on incomes exceeding Rs. 25,000 at rates varying from a minimum of one anna in the rupee on incomes not exeeeding Rs. 35,000 to a maximum of five annas and three pies in the rupee on incomes exceeding Rs. 15 lakhs. In Travancore-Cochin the exemption limit was originally fixed at Rs. 2,000 but later on increased to Rs. 3,000. The rates varied from a minimum of 9 pies to a maximum of 4 annas in the rupee on incomes exceeding Rs. 25,000. In addition super-tax was levied on incomes exceeding Rs. 45,000 at rates which varied from 1½ annas to 6 annas in the rupee. In Bengal the exemption limit was Rs. 3,000 for cultivated areas not exceeding 80 acres. Hyderabad had the

highest exemption limit and the lowest rates of tax. The exemption limit was Rs. 10,000 and the rates varied from 6 pies to 3 annas in the rupee. The exemption limit in Rajasthan was Rs. 6,000 and the rates of tax varied from 6 pies to 2 annas and 4 pies.

The rates of tax in all the States were based on the slab system; the first slab of Rs. 1,500 was exempted from tax. The Orissa tax-free slab, however, was fixed at Rs. 3,000. The incidence of the tax in some of the States at different levels of agricultural income is given in the following table.

TABLE LV

INCIDENCE OF AGRICULTURAL INCOME-TAX ON CERTAIN GROUPS OF AGRICULTURAL INCOMES

States	Income group	Rs. 5,000	Rs. 10,000	Rs. 25,000	Rs. 50,000	Rs. 1,00,000
		Tax Burden				
Bihar ..	..	164	633	3,914	12,352	34,695
Assam ..	..	164	555	3,836	10,086	22,586
West Bengal	..	164	555	3,367	9,617	22,117
Orissa ..	..	163	373	2,717	13,186	43,811
Uttar Pradesh	..	219	688	3,031	10,469	32,968
Hyderabad	..	109	422	2,931	7,636	17,046
Travancore-Cochin	..	164	633	3,758	12,664	37,039

Source: *Report of the Taxation Enquiry Commission*, p. 202.

The rates of taxes and the exemption limit are more or less the same after the integration of the States.

From the account given in the foregoing pages it will appear that the taxation of agricultural incomes is, more or less, on the lines of taxation of non-agricultural incomes. It is important to note that in spite of differences of land settlement and types of tenure, most of the Acts had similar provisions regarding the exemption limit and the rates of tax. In future, it is likely that unless the land-revenue system is put on a different basis, agricultural income-tax may be assimilated in the general income-tax system in the country. With the abolition of the intermediaries in the land system, the legislation on ceilings on land and the gradual introduction of co-operative farming, the yield of the tax may be effected.

XIII

WEALTH TAX

INTRODUCTORY

In the last chapter we have surveyed the main features of income-tax. We are now in a position to analyse the importance of the wealth tax in the Indian tax-structure. But, before we pass on to give a detailed account of the wealth tax, it is desirable to point out briefly the one important feature of Indian economy which must exercise a profound influence on the tax policy of the Government. The scope of direct taxes is very limited in India, on account of the extreme poverty of the masses and the concentration of wealth in the hands of a microscopic minority of people which makes income alone an inadequate basis of taxation. The importance of the above statement is apparent from the following tables showing the number of persons paying income-tax and super-tax in the various income brackets.

TABLE LVI

INCOME-TAX

Income Rs.		Number of Assessees	Per cent of total number	Tax demand (In lakhs of rupees)
3,601—5,000	..	1,23,803	32.9	1.42
5,001—7,200	..	99,239	26.4	2.45
7,201—10,000	..	57,387	15.3	2.90
10,001—12,500	..	27,592	7.3	2.38
12,501—15,000	..	16,098	4.3	2.10
15,001—20,000	..	17,568	4.7	3.71
20,001—25,000	..	10,033	2.7	3.43
Over 25,000	..	23,953	6.4	31.21
Total	..	3,75,673	100.0	49.60

TABLE LVII

SUPER-TAX

Income Rs.		Number of Assessees	Per cent of total number	Tax demand (In lakhs of rupees)
25,001—40,000	..	16,094	56.7	1.72
40,001—55,000	..	5,534	19.5	2.33
55,001—70,000	..	2,383	8.4	2.04
70,001—85,000	..	1,415	5.0	2.07
85,001—1,00,000	..	787	2.8	1.65
100,001—1,50,000	..	1,183	4.2	4.10
150,001—2,00,000	..	420	1.5	2.45
Over 2,00,000	..	550	1.9	10.92
Total ..	..	28,366	100.0	27.28

The above two tables are extremely significant in showing that the income-tax assessees are very small relatively to the total population being between 1 and 1.5 per cent. This means that about 99 per cent of the population have incomes of below Rs. 3,600 per year. A further analysis of the super-tax figures points out that only 550 persons in the whole of India had incomes of over Rs. 2 lakhs per year. Besides, it is important to keep in view that a very large number of assessees in the earlier super-tax slabs are salaried persons whose wealth may be a very modest figure. It is only in the last few slabs that the actual concentration of wealth is centred in the country. The above statements give us a rough idea of the degree of inequality of income due to inequality of wealth-distribution in the country which requires deep attention in formulating schemes of direct taxation. The obvious conclusion is that taxation of capital in the shape of (*i*) a tax on wealth; (*ii*) capital gains tax; (*iii*) estate duties; and (*iv*) a gift tax must form an important feature of Indian tax-structure. Taxation of income alone is inadequate in introducing equity in the Indian tax-structure.

The object of this chapter is to analyse the theoretical implications of a wealth tax and the desirability of its levy in India. The chapter is divided into four sections. Section I

points out the desirability of a wealth tax in a socialistic pattern of society. A theoretical discussion of a wealth tax is given in Section II. In Section III the main features of the Indian wealth tax are stated. Finally, some of the administrative problems are stated in Section IV.

§ 1. *NECESSITY FOR WEALTH TAX IN A SOCIALISTIC PATTERN*

A tax on wealth is the logical outcome of the decision of the nation to achieve a socialistic pattern of society. Extreme inequality of income, which is the product of inequality of wealth, prevails in the country. We have already pointed out that there were only 550 persons in the whole of India who were paying super-tax on incomes of over Rs. 2 lakhs and 28,366 persons paid super-tax (i.e. had incomes of over Rs. 25,000). Such a state of affairs cannot be tolerated in any democratic society. If a socialistic pattern for our nation has any meaning, there must be levelling down of wealth to remove extreme inequality of income and wealth in the country.

Socialistic-Pattern Goal of India

Our Constitution starts with the Preamble that we, the People of India, resolve to secure to all its citizens justice—social, economic and political. Equality of status and of opportunity has again been expressed in one of the Fundamental Rights which lays down that there shall be equality of opportunity for all citizens in matters relating to employment or appointment to any office under the State. Again, the Directive Principles of State Policy, (though not enforceable by any court) clearly indicate that a socialistic pattern of society is the goal of our Constitution. The Directive Principles point out that in framing economic laws the State shall direct its policy towards securing

1 That all citizens, men and women equally, have the right to an adequate means of livelihood;

2 That the ownership and control of the material resources of the community are so distributed as best to subserve the common good;

3 That the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment.

The above principles and ideas form the basis of the approach to the Second Five-Year Plan which points out that the basic criterion for determining the lines of advance is not private profit but social gain. The benefits of economic development, the Plan observes, must accrue more and more to the relatively less privileged classes of society, and there should be a progressive reduction of the concentration of income, wealth and economic power. The problem is to create a milieu in which the small man, who so far has little opportunity of perceiving and participating in the immense possibilities of growth through organized effort, is enabled to put forth his best in the interest of a higher standard of life for himself and increased prosperity for the country.

Perfect Equality an Impossibility

In view of the above-declared goal of State policy the question arises: How is it to be achieved? The path is full of difficulties and any radical solution may not be within the range of practical possibility. We may recall what Bentham once said: 'The establishment of a perfect equality is a chimera; all we can do is to diminish inequality.'[1] How far we can travel on the road to achieve complete equality depends upon the will of the nation. But the road undoubtedly is far longer than the present generation can cover. One needs only to be reminded that the longer we travel on the road the greater will be the prospects and opportunities of unprecedented promise, which we will be providing for the common man to modify his status in an unkind world.

Causes of Inequality of Income

Professional economists are generally in agreement both as to the causes of inequality and to how far they are remediable. To say that inequalities of income coincide with inequalities of merit is to take a shallow view of the case. Prof. Dalton has correctly observed that most of the larger inequalities

[1] *Theory of Legislation*, p. 120.

of income are due to the fact that men do generally start fair in the pursuit of income and the notion that inequalities coincide with merit is fallacious when income from property is concerned.[1] The lack of opportunities which bring success in life is much more pronounced in underdeveloped countries than in developed economies with the result that the accumulation of wealth in comparatively few hands is common. Potential entrepreneurs are very often denied opportunities and persons who, given the opportunity, would contribute in raising the national income are ignored. In underdeveloped countries, society is stratified by caste, colour or creed and a large section of the population is deprived of opportunity by law, custom or by chicanery.

One of the major problems in such countries is the removal of the concentration of economic power.

To discuss in any detail the causes of inequality of income is beyond the scope of this chapter. Nevertheless, it may be pointed out that the causes of inequality may be reduced to 'inborn differences of gifts and the maintenance of acquired advantages through environment and through inheritance of property'. It is most essential that existing disparities in the distribution of wealth must be removed to achieve the socialistic pattern of society in India. It is difficult to state exactly what a socialistic pattern of society means. However, it is desirable that the State should try to achieve the ideal of providing every citizen with a national minimum of a real income which 'must be conceived not as a subjective minimum of satisfaction, but as an objective minimum of conditions. The conditions, too, must be conditions not in respect of a particular aspect of life only, but in general.'[2] Broadly speaking, the contents of the above minimum may be stated under four heads:

(*i*) The provision of adequate food, clothing, medical attendance, education, and other essentials for all children. This would reduce the influence of environment and opportunity which is one of the major causes of inequality of incomes;

[1] *Inequality of Income*, p. 240.
[2] Benham, op. cit. pp. 240-1.

(*ii*) The removal of insecurity of employment;
(*iii*) The reduction of inequality of income through taxation; and
(*iv*) The improvement of productive capacity of the masses through public expenditure.

To achieve the above objectives a transfer of wealth from the 'haves' to the 'have-nots' is necessary, especially in a country like ours where there is an extreme concentration of wealth in the hands of a very small minority of people.

§ 2. *THEORY OF WEALTH TAX*

Three Types of Wealth Taxation

A tax on wealth may take three forms:

1 Capital levies which may be imposed on special occasions once for all or may be repeated sometimes;
2 Estate duties which are imposed when the property passes from the dead to the living; and
3 A tax on wealth which may make an annual feature like an income-tax.

Each of these three types of taxes has an important role to perform in taxing the ability of an individual to pay taxes. Each may fill in a distinct gap in the tax-structure of a country. A somewhat detailed analysis of the estate duties is given in Chapter XIV. A passing reference to all these taxes is made here with a view to pointing out the distinction between capital levies, estate duties and an annual tax on wealth.

Capital Levies and Estate Duties

Capital levies are usually imposed on special occasions when the State is in need of a huge amount of revenue to pay off its obligations. For instance, at the close of a war when huge fortunes have been made and the public debt has mounted it may be desirable to impose capital levies to pay off the war debt as well as to tax the abnormal accumulation of wealth in the hands of certain classes of society. Besides, a capital levy may have a deflationary effect but the occasions when capital levies can be imposed are very few indeed and it would be inadvisable in the present context of the

economic conditions of India to suggest the imposition of such levies.

Estate duties form a common feature in the tax-structure of almost every democratic State. A tax on the transfer of property from the dead to the living is imposed because it taxes an important element of ability which income-tax cannot reach.

It is now commonly recognized that any single test of ability for the purpose of taxation, whether it be income or capital or saving or expenditure, is bound to have many defects. Hence in every country we have a manifold tax system. Although income is the best single measure of ability it is not enough to tax the ability of an individual from every point of view. Estate Duties charged on capital fill in the gap. They provide for an important element of ability which income-tax cannot touch except in an inadequate way. An inheritance tax is a tax on capital and is paid once at the time of death. Income-tax is a tax on income and is paid every year.

Income-Tax and Wealth Tax

A tax on wealth differs essentially from capital levies or estate duties in the sense that it is to be levied annually on the wealth of an individual. It also differs from income-tax as it looks upon the wealth or the assets of an individual as the base of taxation; the base of taxation of income-tax being the annual income of an individual.

It may, however, be pointed out that income-tax is closely linked with a tax on wealth. The two types of taxes tax the ability of a tax-payer. In one case the base of the tax is annual income, in the other, wealth. In actual practice there may be little distinction between these two taxes since a tax which may be assessed on income may indeed be paid out of wealth while a tax on wealth may be paid out of the income of an individual. For example, a high income-tax in war may be paid by an individual, without reducing his standard of living, by the sale of his assets. Similarly, a tax on wealth year after year may be paid out of income. Thus theoretically there is little distinction between an income-tax and a wealth

tax because an income-tax may be paid out of wealth; and a tax on wealth may be paid out of income.

A tax on wealth, like an income-tax, possesses an advantage over indirect taxes in so far as it can be closely adjusted to ability to pay. Perhaps in no other direct tax is the principle of ability satisfied to a greater extent than it is in the case of a tax on wealth. The possession of wealth gives the owner social and economic advantages which increase his opportunity to earn income. It is now commonly recognized that the greatest cause of inequality of income in modern societies is due to inequality of inherited wealth. Social security cannot be widely diffused unless inequality of wealth is reduced to the largest possible extent. Inequality of wealth, if we may be permitted to use an expression, gives a 'capitalist surplus' to one individual over the other and this surplus gives rise to differences in the ability of an individual to earn income. The one object of the socialistic pattern of society in India must be to reduce this 'capitalist surplus' which can be achieved to a large degree through an annual tax on wealth.

Again, a high rate of income-tax discourages incentive and enterprise and may result in tax evasion. An annual tax on wealth, even though it may be paid out of income, probably is less likely to produce such an effect since the tax base is related to the past earnings of either the present owner or in most cases to his inherited wealth. Therefore, there is a good case for a tax on wealth especially if the rate of income-tax cannot be increased beyond a certain limit. A possible objection to such a tax may be pointed out if a tax on wealth results in a loss in investment every year, or what may be called, it may result in 'capital consumption' if the community does not make enough provision for the future. This objection is only tenable if saving equal in value to the tax paid does not take place in the community as a whole. This, perhaps, is highly improbable as in a long period capital consumption of any serious nature must disappear as new public investment shall outweigh such a state of affairs. In normal times the community probably will not be suffering from the danger of undersaving.

Tax-Payer's Preference

Having stated the case for a tax on wealth from the point of view of the principle of ability we pass on to examine another consideration in such a tax, viz. the tax-payer's preference. Assuming that a certain amount of tax is to be raised in the country and the tax-payer is required to give his preference: Will he prefer a bill based wholly on his annual income or partly on income and partly on wealth? Would he prefer a high rate of income-tax to meet his tax liability and keep his wealth intact or would he prefer to pay a part of his liability out of his annual income and a part of his wealth?

The answer to the above question in the case of once for all capital levy and death duties is a simple one. The unforeseen nature of capital levies and death-duties probably may make it inevitable for the tax-payer to dispose of his assets to pay off the liability. But in case the tax is an annual feature based on wealth the tax-payer's preference resolves itself into the choice of (1) a gradual reduction in the value of his assets or (2) a lower income which leaves his wealth intact. A tax on wealth will result in a loss of satisfaction to the tax-payer either through a loss of income or loss of wealth. The tax-payer's preference would depend upon the rate at which he would equate the loss of these two satisfactions to meet the tax liability. Thus in case the tax-payer feels the loss of satisfaction due to the reduction in the size of his wealth, he will pay his additional liability by liquidating part of his wealth rather than reduce the amount of his income. On the other hand, if his income has enough surplus he may pay off the additional liability by reducing his income rather than reducing his assets. The rate of equation will depend upon the tax-payer's preference in each society upon the surplus income.

Loss of Satisfaction Compared

The tax-payer's preference for wealth tax, at a particular point of time, may be expressed by an arithmetical example. Suppose, the tax-payer is required to pay a wealth tax of one lakh rupees. He may pay the bill either out of his wealth or he may borrow the one lakh rupees from a bank and pay interest on the amount and reduce his annual income to the extent

of the interest paid by him. With a 3 per cent rate of interest, a wealth tax of one lakh rupees is equated with a reduction of Rs. 3,000 in annual income. The tax-payer's loss of satisfaction of one lakh rupees as wealth tax is equal to a loss of satisfaction of Rs. 3,000 in a reduced annual income. The tax-payer's preference in choosing either of these two positions would depend upon his equation of the loss of these two satisfactions. Thus in case the tax-payer feels the loss of satisfaction due to a lower income of Rs. 3,000 much more than a loss in satisfaction due to the reduction of one lakh rupees in the size of his wealth, he will pay the wealth tax by liquidating a part of his assets. On the other hand, if his income has enough surplus he may pay the wealth tax out of his annual income and not reduce the size of his wealth.

The above analysis is in harmony with the theory of public loans which makes, from the point of incidence, no distinction between a loan and a tax. This may be illustrated by a simple example. Let us suppose that in a society the State decides to raise an extraordinary tax of Rs. 100 crores from all the citizens and each one is required to pay Rs. 10,000 as tax. We can imagine a person called upon to face the bill which, because of its magnitude, he decides to borrow and meet its incidence from his annual income by paying interest to an individual. He does not want to pay it by selling a part of his property. Doubtless he will be able to contract a loan which, from a theoretical point of view, is an attenuated form of alienation. The process of borrowing from an individual to meet the extraordinary tax may be repeated by a large number of people. The State, under such conditions, may, in order to do away with the roundabout cumbersome process, think it desirable to raise the entire amount of the extraordinary tax in the form of a loan from an individual to whom it may pay interest and may levy a tax (equal to the amount of the interest paid to the individual) from all the members of the community. In actual practice the interest on public debt is a matter of debit and credit to the State. It amounts to a payment of tax by each individual equal to the interest which he would have paid to the bank if he had borrowed the amount himself to meet the extraordinary loan.

The process in the case of a wealth tax may, in a large number of cases, be exactly on the lines indicated above, when the State decides to raise an extraordinary tax. A low-rate wealth tax may, in actual practice, mean a reduction in the annual income of a tax-payer.

§ 3. *MAIN FEATURES OF WEALTH TAX*

The main features of the Wealth Tax may be summarised as follows:

(*a*) In computing the net wealth of an individual, there shall be included, as belonging to him, the value of assets which on the valuation date are held:

(*i*) by his wife to whom such assets have been transferred by the individual, directly or indirectly, otherwise than for adequate consideration or in connection with an agreement to live separately; or

(*ii*) by a minor child not being a married daughter to whom such assets have been transferred by the individual otherwise than for adequate consideration; or

(*iii*) by a person or association of persons to whom such assets have been transferred by the individual otherwise than for adequate consideration for the benefit of the individual or his wife or minor child; or

(*iv*) by a person or association of persons to whom such assets have been transferred by the individual otherwise than under an irrevocable transfer.

Whether the assets referred to in any of the sub-clauses aforesaid are held in the form in which they were transferred or otherwise;

(*b*) where the assessee is a partner in a firm or a member of an association of persons, the value of his interest in the firm or association is determined in the prescribed manner as laid down in the Act.

Exemptions from Wealth Tax

Wealth Tax shall not be payable in respect of the following assets:

(*i*) any property held by an assessee under trust or

other legal obligation for any public purpose of a charitable or religious nature in India;

(*ii*) the interest of the assessee in the coparcenary property of any Hindu undivided family of which he is a member;

(*iii*) any one building in the occupation of a Ruler declared by the Central Government as his official residence under Paragraph 13 of the Merged States (Taxation Concessions) Order, 1949, or Paragraph 15 of the Part B States (Taxation Concessions) Order, 1950;

(*iv*) one house belonging to the assessee exclusively used by him for residential purposes and situate in any place with a population not exceeding ten thousand and which is more than five miles distant from any area for which there is a municipality the population whereof exceeds ten thousand;

(*v*) the rights under any patent or copyright belonging to the assessee:

Provided that they are not held by him as assets of a business, profession or vocation and no income or benefit accrues to him therefrom;

(*vi*) the right or interest of the assessee in any policy of insurance before the moneys covered by the policies become due and payable to the assessee;

(*vii*) the right of the assessee to receive a pension or other life annuity in respect of past services under an employer;

(*viii*) furniture, household utensils, wearing apparel, provisions and other articles intended for the personal or household use of the assessee;

(*ix*) the tools and implements used by the assessee for the raising of agricultural produce;

(*x*) the tools and instruments necessary to enable the assessee to carry on his profession or vocation, subject to a maximum of Rs. 20,000 in value;

(*xi*) instruments and other apparatus used by the assessee for purposes of scientific research;

(*xii*) any works of art archaeological, scientific or art collections, books or manuscripts belonging to the assessee and not intended for sale;

(*xiii*) any drawings, paintings, photographs, prints and any other heirloom not falling within clause (*xii*) and not intended for sale, but not including jewellery;

(*xiv*) jewellery in the possession of any Ruler, not being his personal property, which has been recognized before the commencement of the Wealth Tax Act by the Central Government as his heirloom or, where no such recognition exists, which the Board may subject to any rules that may be made by the Central Government in this behalf, recognize as his heirloom at the time of his first assessment to wealth-tax under the Act;

(*xv*) jewellery belonging to the assessee, subject to a maximum of Rs. 25,000 in value;

(*xvi*) ten-year treasury savings deposit certificates, fifteen-year annuity certificates, deposits in post office savings banks, post office cash certificates and post office national savings and certificates held by the assessee;

(*xvii*) the amount standing to the credit of an assessee, being a salaried employee, in any provident fund maintained by his employer to which the Provident Fund Act, 1925, applies or which is a recognized provident fund within the meaning of Chapter IX(A) of the Income-Tax Act;

(*xviii*) the property received by an assessee from Government in pursuance of any gallantry or merit award instituted or approved by the Central Government;

(*xix*) the value of any shares held by the assessee in any other company in any case where the assessee is a company;

(*xx*) the value of any shares held by the assessee in any company referred to in clause (*d*) of Section 45, if on the relevant valuation date the provisions of the Act are not applicable to the company by reason of the provisions contained in that section;

(*xxi*) that portion of the net wealth of a company established with the object of carrying on an industrial undertaking in India within the meaning of the Explanation to clause (*d*) of Section 45, as is employed by it in a new and separate unit set up after the commencement of this Act by way of substantial expansion of its undertaking.

Assessment

Every person whose net wealth exceeds the taxable limits shall, before June 30 furnish the Wealth-Tax-Officer a return in the prescribed form and verified in the prescribed manner setting forth his net wealth on the valuation date.

If the person who is required to pay the wealth-tax does not furnish the correct statement of wealth there are certain penalties provided for in the Act. Section 17 of the Act relates to the wealth-escaping assessment.

Wealth-Escaping Assessment

(*a*) If the Wealth-Tax Officer has reason to believe that on account of omission or failure on the part of the assessee in declaring his net wealth a portion of net wealth chargeable to tax has escaped assessment or assessment has been made at too low a rate; or

(*b*) If the Wealth-Tax Officer in consequence of any information in his possession has reason to believe, notwithstanding that there has been no such omission and failure as referred to in (*a*) above, that the net wealth chargeable to tax has escaped assessment for any year, whether by reason of under-assessment or assessment at too low a rate, he may, in cases falling under clause (*a*) at any time within eight years and in cases falling under clause (*b*) at any time within the four years of the end of that assessment year, proceed to assess or re-assess the net wealth of the individual.

Penalty for Concealment

The Act also provides penalty for concealment of wealth chargeable to tax. Thus, if the Wealth-Tax Officer is satisfied that any person

(*a*) has without reason failed to furnish the return of his net wealth within the time allowed and in the manner required;

(*b*) has without reasonable cause failed to comply with a notice served by him; or

(*c*) has concealed the particular items of his assets and deliberately furnished inaccurate particulars of his assets or debts;

he may ask such persons to pay by way of penalty:

(*i*) in case referred to in (*a*) in addition to the amount of wealth-tax payable by him a sum not exceeding one and a half times the amount of such tax; and

(*ii*) in case referred to in clause (*b*) and (*c*) in addition to the amount of wealth-tax payable by him a sum not exceeding one and a half times the amount of the tax if any, which would have been avoided, if the net wealth returned by such person had been accepted as correct.

Rates of Wealth-Tax

The Act provides the following rates of wealth-tax:

(*a*) In the case of every individual:

(*i*)	on the first rupees two lakhs of net wealth	Nil
(*ii*)	on the next rupees ten lakhs of net wealth	½%
(*iii*)	on the next rupees ten lakhs of net wealth	1%
(*iv*)	on the balance of net wealth	1½%

(*b*) In the case of every Hindu undivided family:

(*i*)	on the first rupees four lakhs of net wealth	Nil
(*ii*)	on the next rupees nine lakhs of net wealth	½%
(*iii*)	on the next rupees ten lakhs of net wealth	1%
(*iv*)	on the balance of net wealth	1½%

(*c*) In the case of every company:

(*i*)	on the first rupees five lakhs of net wealth	Nil
(*ii*)	on the balance of net wealth	½%

Provided that in the case of a company which has incurred a net loss in any year computed in the manner hereinafter provided and which has not declared any dividend on its equity capital in respect of that year, the rate of tax for the relevant year shall be nil.

The loss referred to in the above proviso shall be computed in accordance with the provisions of sections 8, 9, 10 and 12 of the Income-Tax Act but without deducting the allowances referred to in paragraph (*b*) of the proviso to clause (*vi*) of Sub-section (2) of section 10, sub-clause [VI(*a*)] and sub-clause [VI(f)] of sub-section (2) of section 10 of that Act or the allowance in respect of any losses brought forward from earlier years.

Rule 1.—Where the net wealth of an assessee includes the value of any asset on which wealth-tax is not payable under sub-section (2) of section 5, the amount of tax payable by the assessee shall be an amount bearing to the total amount of wealth-tax which would have been payable on the net wealth had no property been exempt the same proportion as the unexempted portion of net wealth bears to the net wealth.

Rule 2.—Where the net wealth of an assessee not being a company, in respect of any assessment year, includes the value of any shares in a company as defined in section 3 of the Companies Act, 1956, the wealth-tax payable by the assessee on his net wealth for that assessment year, computed in accordance with the rates specified above, shall be reduced by the amount, if any, by which the sum of the following, namely:

(*a*) that portion of the wealth-tax payable by the assessee computed as aforesaid as bears to the whole amount of the tax, the same proportion as the value of the shares aforesaid included in his net wealth bears to his net wealth,

(*b*) that portion of the wealth-tax, if any, paid by the company in respect of the same assessment year, as bears to the whole amount of the said tax, the same proportion as the paid-up value of the shares included in the assessment of the assessee aforesaid bears to the aggregate paid-up value of the share capital of the company as on the relevant valuation date, exceeds the amount calculated at the rate of 1.5 per cent on the value of the shares included in his net wealth.

Rule 3.—Where an assessee is an individual who is not a citizen of India and who is not resident in India, the wealth-tax payable by him in respect of any assessment year computed in accordance with the rates specified in this schedule shall be reduced by an amount equal to 50 per cent thereof.

Rule 4.—Where the net wealth of an assessee, being an individual who is a citizen of India, or a Hindu undivided family, includes any assets located outside India, the wealth-tax payable by the assessee in respect of any assessment year shall be reduced by an amount which bears to the amount of tax that would have been payable by the assessee if the rates of tax had been reduced to one-half of the rates specified in this Schedule the same proportion as the value of the assets located outside India as reduced by the debts located outside India bears to the net wealth of the assessee.

Rule 5.—Where the profits of a company in respect of any year, before deducting any of the allowances referred to in the second paragraph of the proviso to Part II, are less than the amount of wealth-tax payable by it in respect of the relevant assessment year, the wealth-tax payable by the company for such assessment year shall be limited to the amount of such profits:

Provided that the company has not declared any dividend on its equity capital in respect of that year.

XIV

ESTATE DUTY

§ 1. *THEORY OF ESTATE DUTY*

An attempt will be made in this chapter to examine the theory of death duties and the main provisions of the Indian Estate Duty Act.

The Equity of Death Duties

A tax on the transfer of property from the dead to the living is an important feature in the tax system of almost every democratic State. The tax as a fiscal instrument has been justified from a social as well as from a theoretical point of view. 'Property rights', observes Professor Pigou, 'are the child of law!'[1] It is universally recognized that as the State protects the property of the individual after his death, it is justified in taking a share of the property before it passes on to the beneficiaries. Gladstone in his speech on succession duties remarked; 'The carrying of property in perfect security over the great barrier which death places between man and man is perhaps the very highest achievement, the most signal proof of the power of the civilized institutions...and an instance so capital of the great benefit conferred by law and civil institutions upon mankind, and of the immense enlargement that comes to natural liberty through the medium of the law, that I conceive nothing more rational than that, if taxes are to be raised at all, the State shall be at liberty to step in and take from him who is thenceforward to enjoy the whole in security that portion which bona fide may be necessary for the public purpose.'[2] Hence a statute passed by the State for the curtailment of the right of bequests in respect of the property hitherto enjoyed by the deceased is just.

Apart altogether from the social point of view, death duties

[1] Pigou, A. C., *A Study in Public Finance*, Macmillan, p. 7.
[2] *Hansard*, Vol. Cxxxii, 1853, p. 267.

are theoretically justified on the principles of ability, certainty and convenience. It is now commonly recognized that any single test of ability for purposes of taxation, whether it be the amount of income or capital, of savings or expenditure, is bound to have many defects.[1] Hence we have a manifold tax system. Although income is the best single measure of ability, it is not comprehensive. Therefore a different test of ability to pay taxes is needed. Death duties, charged on capital, fill the gap. They provide for an 'important element of ability which an income-tax cannot recognize, except in the most inadequate way.'[2] This may be made clear by an example. Suppose A, B, and C each have an income of Rs. 10,000 from earnings, speculative holding of shares, and gilt-edged securities, respectively. Both B and C are enormously better off than A, and C is also better off than B. But if all of them are required to pay the same amount of income-tax it may be unjust. A has nothing but a power of earning; B's income will fluctuate with the money market; C need have no worry with financial uncertainties at all. Income-tax alone, however nicely differentiated, is entirely inadequate to meet the equities of the case. This kind of maladjustment can be substantially removed by death duties. The death-duty rates in most countries are progressive, the rates being heavy in the higher ranges of capital.

Moreover, death duties are also a useful supplement to income-tax in another way. The death duties extend (e.g. the English estate duty) to assets such as jewels, pictures, furniture and other goods not producing income; they also tax wealth due to unearned increments in land and other capital transactions.

Thus death duties on the scope of ability are justified. Equality in taxation is secured to a greater extent than is possible under income-tax alone.

Death duties are in conformity with Adam Smith's canons of certainty and convenience. The amount which each individual is bound to pay is certain, and not arbitrary. The

[1] *See* Appendix 1.
[2] *Report of the Committee on National Debt and Taxation*, Cmd. 1810, 1927, p. 178. (H.M.S.O.)

time of payment, the manner of payment, the quantity to be paid are clear and plain to the contributor, the deceased, and to every other person.[1]

Finally, death duties are most convenient to pay, whether regarded from the point of view of the owner of the property or the beneficiaries. Death duties are regarded as deferred income-tax, the payment of which has been postponed to the time when the property passes from the deceased to those who inherit it. The guiding principle of every tax system must be to reduce the sacrifice of the tax-payers to a minimum. Assuming a given revenue is to be raised by the Government, the resentment of the tax-payers will be reduced to a minimum if, instead of an additional income-tax exacted during the lifetime of the deceased, the amount is collected through death duties. The time for their collection is most opportune; for the heir who inherits the estate feels no great sacrifice, while the deceased beyond the grave is incapable of feeling the loss.

Objections to Death Duties

Theoretically, death duties are open to two objections. First, their yield is uncertain. Secondly they cause inequality between one estate and another because they cannot take into consideration the varying frequency of transfer of property. As Dr. Benham puts it: 'A Chancellor of the Exchequer cannot estimate their yield at all accurately for he does not know which rich men will die during the coming year. Over, say, fifty years, one estate may not change hands at all and so may yield nothing in death duties, while another may change hands several times.'[2] Death duties are thus arbitrary in character.

In spite of these objections death duties are found in the tax system of most countries. The reason for their existence (apart from theoretical considerations) is mainly the practical one of plucking the goose with the least squealing.[3] The most favourable time for their collection reduces the

[1] Adam Smith, op.cit. pp. 310-11.
[2] Benham, *Economics*, p. 306.
[3] Ibid. p. 306.

sacrifice of the tax-payers to a minimum and hence causes the least resentment among them.

Types of Death Duties

Death duties are usually classified under two broad categories: (*i*) an estate duty (e.g. the English estate duty) levied on the estate as a whole; and (*ii*) a succession duty (e.g. the English legacy and succession duty) levied on the separate portions going to each beneficiary. The estate duty is usually graduated by reference to the aggregate value of the property passing, without reference to the interests of the different beneficiaries. In the case of the succession duty the rates are determined solely by the relationship of the beneficiary to the deceased. The succession duty is charged not upon the whole corpus of an estate but upon the interest which a person derives from property left to or devolving on him upon death. The rates are always lower where the beneficiary is the wife, husband or children; they become higher as the relationship of the beneficiaries to the deceased becomes more distant.

Both these types of duties possess some advantages. Simplicity of administration and productivity are the strong features of the estate duty. The succession duty, on the other hand, may be said to be more equitable. Evasion is also less easy under an estate duty than under a succession duty. As the succession duty is based on relationship, the amount of legacy and the wealth of the inheritor, there may be a greater degree of abstract justice in its case. It is, however, advantageous to have both the duties in the tax system. Each will complement the other.

Death duties may be graduated in three ways: (*i*) the tax may vary with the size of the estate transferred: e.g. the rates are progressive in the case of the English estate duty; (*ii*) the rates may vary with the relationship of the beneficiaries to the deceased: the English legacy and succession duties are graduated on this principle; (*iii*) the rates may vary with the amount inherited by each beneficiary and his wealth: death duties in some of the Continental countries are based on the third form.

§ 2. *ESTATE DUTY IN INDIA*

Mitakshara and Dayabhaga Law

One of the most important difficulties in the imposition of death duties in India is the Hindu law of inheritance. The two schools of Hindu law—the Mitakshara and Dayabhaga—differ in regard to the laws of inheritance. According to the Mitakshara law (which is in force outside Bengal) each son upon his birth takes an interest equal to that of his father in ancestral property, whether it is movable or immovable. 'On the death of the father the son takes the property, not as his heir, but by survivorship.'[1] The coparceners in a Hindu joint family do not own property as individuals. Hence a Hindu joint family is a corporate body 'having a continuous existence notwithstanding the death of individual members.'[2]

Under the Dayabhaga law, the sons do not take any interest in ancestral property in the lifetime of their father. Their rights rise for the first time on the father's death. In short, under the Mitakshara law the sons acquire an interest by birth; in the Dayabhaga law they acquire an interest with the father's death. The result of the above distinction is that the interest of the coparceners under the Mitakshara law fluctuates with the birth or death of other coparceners. Hence the imposition of death duties is a matter of difficulty in the case of Hindu joint families governed by the Mitakshara school of law.

Results of the Differences in Laws

From the above legal summary three important consequences follow. First, the choice of the methods of taxation is limited. Any inheritance tax in India (on account of the Mitakshara school of law) which is based on the separate inherited share of each recipient rather than on the whole estate is not possible for India. Hence the application of the principle of progression, based on the windfall element arising out of the degree of relationship of the heir to the deceased,

[1] Mulla, D. F., *Principles of Hindu Law*, Eastern Law House, Calcutta, 1936, p. 323.

[2] Trevelyan, Sir E. J., *Hindu Law as Administered in British India*, Thacker Spink, 1929, p. 213.

cannot be applied in taxing the estate. The English legacy and succession duties are therefore ruled out.

Secondly, the discrimination in taxation of an estate according to the age of the estate is also not possible. It has often been suggested that, in taxing estates, graduation according to the time-element should be introduced. Thus the older the estate the higher should be the rate of the tax on that portion, i.e. taxation should be according to the number of times the estate has already changed hands. Since inheritance under Mitakshara law is by survivorship, discrimination in taxation according to the age of the estate is also ruled out.

Thirdly, the English estate duty, which taxes the whole estate (rather than the shares which pass to each beneficiary), is most suitable to Indian conditions.

History of Estate Duty

The Estate Duty is not a new measure. For the first time in 1925, a measure of this kind was recommended by the Taxation Enquiry Committee. However, its recommendation could not be given effect to on account of the impending constitutional changes beginning with the appointment of the Statutory Commission in 1928 and ending with the passing of the Government of India Act in 1935.

The need for the imposition of an estate duty began to be felt again during World War II which helped many people to acquire enormous private fortunes. The imposition of such a duty on the analogy of the duty existing in Britain, could not be undertaken under the Government of India Act, 1935. Accordingly, in 1944 the Act was amended to confer on the Central Legislature the power to levy an estate duty in respect of property other than agricultural land, the latter falling within the ambit of the Provincial List.

In 1946 a Bill seeking to levy a duty on estates 'passing' or 'deemed to pass' on the death of a person was introduced in the Central Legislature but for various reasons, could not be taken up for consideration. The Bill was reintroduced in the provisional Parliament in 1948 and, although it passed through the select committee stage, it could not

be taken up for consideration and with the dissolution of the provisional Parliament, it lapsed. The present Estate Duty Act was passed in 1952. Articles 366 (9) of the Constitution defines Estate Duty in the following terms:

'Estate duty means a duty to be assessed on or by reference to the principal value, ascertained in accordance with such rules as may be prescribed by or under laws made by Parliament or the Legislature of a State relating to the duty of all property passing upon death or deemed under the provisions of the said laws so to pass.'

The constitutional position of estate duty is that it is included under items 87 and 88 in the Union List under which estate duty in respect of property other than agricultural land and duties in respect of succession to property other than agricultural land, come within the exclusive legislative jurisdiction of the Parliament. But the net proceeds of the duty do not form part of the Consolidated Fund of India; under Article 269 of the Constitution the proceeds are to be distributed among the States under which the duty is leviable.[1]

Estate duty and taxation duty on agricultural land fall under the tax jurisdiction of State Legislature (items 46 and 48) of the State List.[2] However, under Article 252 of the Constitution, Parliament can legislate on these subjects if the legislature of the two or more States passes a resolution to that effect; after such legislation is enacted, it can be extended to the other States by resolution adopted by the legislature of those States. The following States have passed such resolutions and accordingly estate duty is chargeable on agricultural land in these States:

Assam, Bihar, Bombay, Hyderabad, Madhya Bharat, Madhya Pradesh, Orissa, Punjab, Rajasthan, Saurashtra, U.P. and all Part C States.

Thus the value of agricultural land in the above States will be taken into account for determining the rate at which estate duty is payable on the other chargeable property.

The reasons underlying the above constitutional provisions to empower the Government of India to levy estate duty

[1] *See* Appendix II.
[2] *See* Ibid.

is to have uniformity in the incidence of taxation and to avoid conflict in tax jurisdiction.

Property Chargeable

Estate duty is chargeable, subject to certain limitations on the principal value of all property which passes on the death of a person. The term 'property' has been defined in the Act. But the definition is not exhaustive; it only enumerates certain items to cover all movable and immovable property. The following items may generally be regarded to fall within the scope of the tax:

1 all movable and immovable property as is commonly regarded as property or assets—land, buildings, stock-in-trade, goodwill and other business assets, cash money in banks, stocks, shares, securities and other investments, furniture, jewellery and other personal belongings, etc.,

2 any interest in movable or immovable property, e.g. mortgages, interest of a coparcener in joint-family property;

3 the sale proceeds of any interest mentioned in item?

4 or any money or investment for the time being representing such sale proceeds;

5 any property converted from one species into another by any method, for instance, a building exchanged for shares in a company;

6 losses in action—debts or rents due to a person, rights to compensation or damages which a person has at the moment of his death, e.g. compensation for loss of limb in an accident;

7 insurance moneys, annuities purchased or provided by a person; and

8 any other right capable of being reduced to a money value.

Gifts of Property

Certain types of gifts are exempted in the estate-duty laws of practically every country. Under the Indian law it has been provided that property taken as a gift made in contemplation of death shall be deemed to pass on the donor's death

and hence liable to estate duty. A gift is said to be made in contemplation of death where a man who is ill or expects to die shortly of illness, delivers the possession of any movable property to another person. Such gifts are known as Gifts *mortis causa* or death-bed gifts; and no exemption from estate duty is allowed for them.

Gifts *inter vivos* can be made of both movable and immovable property. The Act makes special provisions for bringing them under taxation by providing that gifts of property made under the prescribed statutory period (six months for charitable gifts and two years for other gifts) will be ignored and the property comprised in the gifts shall be deemed to pass on the death of the donor.[1]

Exemptions of Insurance Policies

Insurance moneys received under policies effected on the life of the deceased will be exempt from estate duty to the extent indicated below; irrespective of the fact whether the policy was kept up for the benefit of the donee or not.

(*i*) moneys payable under policies effected on the life of the deceased for paying estate duty or assigned to the Government for payment of estate duty to the extent of the amount of duty payable but not exceeding Rs. 50,000 in the aggregate;

(*ii*) moneys payable under one or more policies of insurance effected by the deceased on his life to the extent of Rs. 5,000; and

(*iii*) moneys earmarked under policies of insurance effected by a deceased parent or natural guardian for the purpose of marriage of any female relative who was dependent for the necessaries of life on the deceased, to the extent of Rs. 5,000 in respect of each such relative.

Property which does not Pass on Death

The following kinds of property amongst others are not

[1] An exception to the general rule that property comprised in a gift made within the statutory period of two years is deemed to pass on the death of the donor is provided if gifts are made in consideration of marriage or which are proved to have been part of the normal expenditure of the deceased provided they do not exceed the limit in value in the aggregate.

chargeable to estate duty, as they do not pass on death and are not deemed to pass on death:

(*i*) Property in which the deceased had an interest only as a holder of an office or recipient of the benefit of a charity, e.g. by the holders of the office of *Mahant* of a *Math*;

(*ii*) Property held by the deceased as trustee;

(*iii*) Settled property in which the deceased's interest failed before it became in interest in possession;

(*iv*) Property settled on the deceased for life but which reverts on his death to the settler.

Property which Passes on Death but which is not Liable to Duty

The following types of property pass on the death but their value is not taken into account for purposes of determining the rate of estate duty chargeable on other property:

1 All immovable property situated outside the dutiable territories;

2 Movable property situated outside the dutiable territories at the time of death unless the deceased was at the time of his death domiciled in India;

3 Household goods including tools of artisans, agricultural implements or other tools necessary to the deceased to enable him to earn his livelihood to the extent of Rs. 2,500 in value;

4 Books not intended for sale;

5 Wearing apparel excluding any precious or semi-precious stones, ornaments etc.;

6 Drawings, paintings, manuscripts, works of art which are of national, scientific or historical interest and which are retained in the family of the deceased or which are given absolutely or bequeathed to Government or to any University or other public institutions.

Property which Passes on Death, and which is Exempt from Duty, but has to be Taken into Account for Determining Rate

The following categories of property which pass on death

are exempt from charge of estate duty but their value will be taken into account for determining the rate chargeable on other property:

(*i*) Agricultural land;

(*ii*) Property taken under a gift made by the deceased within the statutory period of six months in favour of public charity to the extent of Rs. 2,500 in value;

(*iii*) Property taken under a gift made by the deceased for any purpose other than a public charitable purpose within the statutory period of 2 years of death to the extent of Rs. 1,500 in value;

(*iv*) Insurance premium effected by the deceased on his life to the extent of Rs. 5,000;

(*v*) Moneys earmarked under policies of insurance or declaration of trust or settlements effected or made by a deceased parent or natural guardian for the marriage of any of his female relatives dependent upon him for the necessaries of life, to the extent of Rs. 5,000 in respect of the marriage of each of such relatives;

(*vi*) Moneys payable under one or more policies of insurance effected by the deceased on his life for the purpose of paying estate duty or assigned to the Government for the purpose, to the extent of the amount of the duty payable;

(*vii*) Moneys deposited with the Government for the purpose of paying estate duty, together with the duty payable, provided that moneys in respect of which no duty shall be payable shall not exceed Rs. 50,000 in the aggregate.

Incidence and Rates of Estate Duty

Estate duty is levied on the principal value of the estate after aggregation and allowing the permissible deductions at the following rates.

In the case of property which consists of an interest in the joint-family property of a Hindu family governed by the Mitakshara, Marumakkattayam or Aliyasantana laws the rates of estate duty are as follows:

TABLE LVIII

PART I

Slab of estate		Rate of duty	Total value of estate	Total amount of duty payable	Average rate of duty
	Rs.	%	Rs.	Rs.	%
First	50,000	Nil	50,000	Nil	Nil
Next	50,000	5	1,00,000	2,500	2.50
,,	50,000	7½	1,50,000	6,250	4.17
,,	50,000	10	2,00,000	11,250	5.63
,,	1,00,000	12½	3,00,000	23,750	7.92
,,	2,00,000	15	5,00,000	53,750	10.75
,,	5,00,000	20	10,00,000	1,53,750	15.38
,,	10,00,000	25	20,00,000	4,03,750	20.19
,,	10,00,000	30	30,00,000	7,03,750	23.46
,,	20,00,000	35	50,00,000	14,03,750	28.08
Balance		40			

PART II

Property of any other kind pay the following rates of duty.

Slab of estate		Rate of duty	Total value of estate	Total amount of duty payable	Total rate of duty
	Rs.	%	Rs.	Rs.	%
First	1,00,000	Nil	1,00,000	Nil	Nil
Next	50,000	7½	1,50,000	3,750	2.50
,,	50,000	10	2,00,000	8,750	4.38
,,	1,00,000	12½	3,00,000	21,250	7.08
,,	2,00,000	15	5,00,000	51,250	10.25
,,	5,00,000	20	10,00,000	1,51,250	15.13
,,	10,00,000	25	20,00,000	4,01,250	20.06
,,	10,00,000	30	30,00,000	7,01,250	23.38
,,	20,00,000	35	50,00,000	14,01,250	28.03
Balance		40			

PART III[1]

In the case of shares held by a deceased member in any company incorporated outside India which has been treated for the purpose of Indian Income-Tax as resident for two out of the three completed assessments immediately preceding.

	Rate of duty
(1) If the principal value of the shares does not exceed Rs. 5,000	Nil
(2) If the principal value of the shares exceed Rs. 5,000	$7\frac{1}{2}\%$

From the account given in the foregoing pages it will appear that the estate duties have filled in an important gap in the Indian tax-structure. Its incidence is not heavy. Indeed the exemptions provided for under the Indian Estate Duties Act are very liberal as compared with exemptions allowed under the estate duty laws of other countries.

Yield from Estate Duties

The yield from estate duties in some years has been as follows:

Year			Amounts (in crores of rupees)
1954-55	..	..	0.81
1955-56	..	..	1.81
1956-57	..	..	2.52
1957-58	..	..	2.52

The yield of estate duty has been rather poor, perhaps on account of the difficulties in ascertaining the total value of property deemed to pass on death. It is popularly believed that because of an absence of statistical data, a very large volume of wealth escapes taxation. With the introduction of the wealth tax it is likely that the yield from estate duties may be increased considerably. In any case, the administrative machinery needs an improvement to increase the yield from estate duties.

[1] The rates in Part I and II have been fixed on the slab system (as in the case of income-tax). That is to say, progressively increasing rates are prescribed for each successive slab of the principal value. No duty is payable on the first slab of Rs. 50,000 or Rs. 1,00,000 as the case may be. Any person domiciled in India will not normally be concerned with rates prescribed in Part III.

XV

EXPENDITURE AND GIFTS TAXES

§ 1. *EXPENDITURE TAX*

In a manifold tax system there are various tests of the ability of an individual to pay taxes, e.g. income, capital and expenditure. Indirect taxes on expenditure in the shape of customs, excise duties, sales or purchase tax have been levied in most countries as substantial revenue-yielders. But these taxes are indirect taxes and are proportional, if not regressive, in their incidence. A personal tax on expenditure with a high exemption-limit is a progressive direct tax and can be made an instrument to bring equity in the tax-structure of an underdeveloped country with sharp differences in the distribution of income and wealth. A high expenditure-tax can be used to check wasteful expenditure and can also help in capital formation. Above all it may be one of the most important measures to help the revenue authorities in checking evasion in the payment of income and other direct taxes. It may yield a substantial revenue to the Government.

Arguments in favour of Expenditure Tax

The case for an expenditure tax may be argued on grounds of: (*i*) the change in the behaviour of the tax-payers on their incentive to save and invest; (*ii*) making the administration of income-tax more effective; (*iii*) as an effective check in finding out the meeting of personal expenditure out of business accounts and (*iv*) a potent weapon for capital formation by the restriction of expenditure among the well-to-do classes.

On theoretical grounds an expenditure tax is superior to income-tax, both because expenditure is more strictly definable than income as a basis of taxation and because expenditure is a better index of taxable capacity than income. Besides, there is nothing wrong in having both a tax on expenditure and a tax on income side by side. Indeed one could

support the other in distributing the incidence of taxation at different levels of incomes.

Behaviour of Tax-Payers

Perhaps the greatest argument to justify the introduction of an expenditure tax under the present economic conditions in India is that it checks excessive personal spending, especially because such a restriction cannot be attained by a further increase in income and property taxes. Prof. Kaldor rightly observed that the present high marginal rates of taxation on income would have had far more deleterious effects on the behaviour of wealth owners than they have produced (that is on their incentive to save or to invest) if these taxes had been applied effectively. The fact that these taxes are largely avoided because the tax system contains large enough loopholes to permit the owners of risk capital to make tax-free gains and to accumulate capital out of tax-free savings, is an argument against the present system of taxation and not against the expenditure tax itself.

For if these loopholes were closed, i.e. all capital gains etc. were brought into charge in the same way as other incomes, it would soon become evident that these high marginal rates on income cannot be maintained. Hence, progressive taxation, if it is to be both effective and important, cannot be levied beyond a certain point on income alone as the base of taxation; it can only be imposed on expenditure as an additional base of taxation.

It is again incorrect to say that the imposition of taxes on property, say, wealth tax, and estate duties, would cancel the advantages of an expenditure tax in restricting expenditure. On the contrary, the imposition of a personal expenditure tax would counter the disincentive effects of these property taxes on the spending and saving habits of the rich. Property taxes cut down the rates of accumulation but encourage spending. A combination of the two types of taxes far from cancelling the good effects of either make it possible to restrict effectively the living standards of the rich without sacrificing the long-run egalitarian objective of a more even distribution of property.

Checking Tax Evasion

While an expenditure tax alone may be more difficult to handle administratively than the present income-tax; it is not more difficult to handle than a comprehensive and effective system of income taxation. On the contrary, the incorporation of an expenditure tax in a system of personal taxation which includes both taxes on income (including capital gains) and on property would ease considerably the prevention of evasion—partly because it would introduce an opposition of interest between the different parties as regards the concealment of particular transactions and partly also because the necessity to account for the amounts spent on personal purposes over a particular period together with the obligation to produce a personal balance sheet of personal net wealth at the beginning and at the end of the period, forces the tax-payer into a full disclosure of receipts; just as the need to make a full return of current receipts and expenditure forces the tax-payer into a full disclosure of capital assets.

Check to Business Expenditure

One of the most important difficulties in the assessment of company accounts is that personal expenses are met out of business expenditure; indeed benefits are sometimes given in kind rather than in cash. The obligation of a tax-payer to return his personal expenditure as well as his income would make it easier to detect such cases of income-tax evasion since they would be reflected automatically in an unduly low-figure return for personal expenditure. The plain fact is that the incorporation of an expenditure tax would make the administration of income-tax a great deal more effective as well. A man who keeps several houses, a large number of servants and several cars and entertains frequently, might well manage to understate his true expenditure by a few thousands a year. But he could not possibly return a figure of say, Rs. 10,000 when indeed he spent Rs. 50,000 or 1,00,000.

Capital Formation

Finally, a progressive expenditure tax is a most potent weapon for introducing economies in personal spending

among the well-to-do classes. It is beyond dispute that an accelerated rate of economic growth requires a higher proportion (and not merely a higher amount) of investment expenditure to total expenditure, i.e. a higher proportion of savings in the national income resources for such additional savings can only come from a reduction in consumption in relation to current income. (As the consumption standards of the masses of the population in India are so near to the bare minimum level, a reduction in the propensity to consume of the well-to-do classes appears as an indispensable requirement for an accelerated rate of capital formation. A drastic reduction of luxury consumption is indeed the only part of the national expenditure that could be released for a higher rate of capital accumulation; and a graduated progressive-tax on personal consumption is undoubtedly the ideal instrument for attaining this end.

Arguments against Expenditure Tax

The arguments against an expenditure tax in the particular context of India may briefly be summarised as follows:

1 It would not be practicable to impose an expenditure tax on top of the present taxes on income, since this would make taxation altogether too severe.

2 Taxation of expenditure to replace taxation of income means the exemption of savings; this would greatly stimulate accumulation by the wealthier classes and would lead to an even greater concentration of property ownership. If taxes on property were imposed to counter the tendency towards the concentration of property, this in turn, would cancel the advantages of the expenditure tax in regard to the incentive to save.

3 The expenditure tax would be more difficult to handle administratively than the income-tax.

4 As expenditure met out of agricultural income would have to be exempted from taxation it would encourage people to debit the maximum part of their expenditure against their agricultural income.

We have already answered some of the arguments as stated above. Administrative difficulties have been advanced as the

most important argument against the expenditure tax. It has been pointed out that the assessee must give full information on the totality of his affairs which may be rather highly inconvenient for him. The administrative difficulties have been overemphasized since a rough estimate puts the total number of assessees who may be required to pay the tax as between 6,600 to 4,500 for individuals, and 1,500 for Hindu undivided families (it may be mentioned that the tax is levied only on individuals and Hindu undivided families and not on other classes, such as companies, firms or associations). It may not be difficult for the Revenue Department (with additional staff) to go into the cases of about 8,000 assessees. The enquiries made by officials in connection with assessments can hardly be called an encroachment on the personal and private affairs of the assessee. Besides, an aggrieved assessee has a right to file an appeal to the Appellate Assistant Commissioner and so on. Above all, it must be remembered that taxation will defeat its very purpose, if evasion on a large scale is not checked and the richer classes escape the payment of taxes.

Main Features of Expenditure Tax

The main features of the Expenditure Tax may be summarised as follows:

The tax came into force with effect from April 1, 1958.

Charges of Expenditure Tax

It shall be charged for every financial year, with effect from April 1, 1958 on the expenditure incurred by an individual or by a Hindu undivided family, in the previous year. No expenditure tax shall be payable by an assessee for any assessment year if his income from all sources during the relevant previous year, as reduced by the amount of taxes to which such income may be liable under any other law for the time being in force, does not exceed thirty-six thousand rupees.

Amount to be Included in the Taxable Expenditure

The following amounts shall be included in computing the expenditure of an assessee liable to tax:

(*i*) any expenditure incurred, whether directly or indirectly by any person other than the assessee in respect of any obligation or personal requirement of the assessee or any of his dependents which, but for the expenditure having been incurred by that other person, would have been incurred by the assessee, to the extent to which the amount of all such expenditure in the aggregate exceeds Rs. 5,000 in any year;

(*ii*) any expenditure incurred by any dependent of the assessee for the benefit of the assessee or of any of his dependents out of any gift, donation or settlement on trust or out of any other source made or created by the assessee, whether directly or indirectly.

Exemption from Expenditure Tax in Certain Cases

No Expenditure Tax shall be payable in respect of any of the following expenditures:

(1) any expenditure, whether in the nature of revenue expenditure or capital expenditure, incurred by the assessee, for business or professional purposes carried on by him for the purpose of earning income;

(2) any expenditure incurred by the assessee, or on his behalf by his employee, wholly and necessarily in connection with the discharge of duties arising out of the assessee's employment;

(3) any expenditure incurred by or on behalf of the assessee wholly and necessarily in connection with the discharge of any duties assigned to him by the Government;

(4) any expenditure incurred on behalf of the assessee by way of any such passage-concessions as are referred to in clause [IV(*a*)] of sub-section (3) of Section 4 of the Income-Tax Act;

(5) any expenditure incurred in connection with the acquisition of any immovable property or in the construction, repair, maintenance or improvement of any immovable property belonging to him;

(6) any expenditure incurred by way of investment in deposits, loans, shares and securities, or in bullion, precious stones or jewellery;

(7) subject to such rules as the Central Government may make, any expenditure incurred by the assessee in the purchase of any cottage industry in India, books or any work of art;

(8) any expenditure incurred by the assessee by way of contribution as capital to a firm or other association of persons in consideration of a share in the profits of the firm or association;

(9) any expenditure incurred by the assessee by way of repayment of loan or other borrowing, or by way of payment of interest, not being interest on any loan or other borrowing utilised for incurring expenditure liable to tax under the Act;

(10) any expenditure incurred by the assessee by way of, or in respect of, any gift, donation or settlement on trust or otherwise for the benefit of any other person;

(11) any expenditure incurred by the assessee for paying premia in respect of any policy of insurance;

(*a*) on the life of the assessee or any of his dependents; or

(*b*) for the education or marriage of any of his dependents; or

(*c*) for insuring the health of the assessee or covering any accident which may befall him or any disability to which he may become subject, or

(*d*) covering any property (other than aircraft, motor vehicles or other transport vehicles) against loss or damage due to fire or theft;

(12) any expenditure incurred by the assessee in the purchase or maintenance of livestock;

(13) any expenditure incurred by the assessee for any public purpose of a charitable or religious nature;

(14) any expenditure incurred by the assessee out of any allowance in the nature of an entertainment allowance referred to in clause (*ii*) of sub-section (2) of Section 7 of the Income-Tax Act in respect of which income-tax is not payable;

(15) any expenditure incurred outside India;

(*a*) from any source by an assessee who is not a citizen of India and is not resident in India; or

(*b*) from any income or capital accrued or realised outside India by an assessee who is not a citizen of India but is resident in India, or being a citizen of India or a Hindu undivided family is not resident or not ordinarily resident in India; or

(16) any expenditure incurred by way of contribution to a provident, thrift or superannuation fund;

(17) any expenditure, not being personal expenditure incurred by the assessee out of the sums, if any, guaranteed or assured by the Central Government as his privy purse for meeting any expenses in respect of:

(*a*) the maintenance of any member of his retinue and the payment of salaries, allowances and pensions to members of his staff or persons who have retired from his service;

(*b*) the maintenance of any one building declared by the Central Government as his official residence under paragraph 13 of the Merged States (Taxation Concessions) Order, 1949, or paragraph 15 of the Part B States (Taxation Concessions) Order, 1950;

(*c*) the maintenance of any conveyances or animals for official purposes;

(*d*) the maintenance of any relatives dependent on him for maintenance;

(*e*) the performance of any official ceremonies; which expenses, having regard to the status of the assessee or to the practice of the family to which the assessee belongs, have to be or are being incurred by him and are, in the opinion of the Expenditure Tax Officer, reasonable;

(18) any expenditure incurred by the assessee or any of his dependents, and where the assessee is a Hindu undivided family, by any member of the family, in connection with any election to any legislative, municipal or other public authority in India, to which such expenditure is not in excess of the limits, if any, fixed under any law for the time being in force relating to such elections.

Deductions to be made in Computing Taxable Expenditure

The following expenditure of an assessee shall be deducted in computing taxable expenditure:

(1) any taxes, including the Expenditure Tax payable under this Act, duties, cesses, rates, or fees paid to the Government or a local authority, but not including:

(*a*) taxes or fees in respect of any conveyance or other movable asset intended for the personal use of the assessee or any of his dependents;

(*b*) customs duties on, or taxes on the purchase of articles, imported or purchased for the personal use of the assessee or any of his dependents;

(2) any expenditure lawfully incurred by the assessee in respect of any civil or criminal proceedings to which he is a party;

(3) any expenditure incurred by the assessee:

(*a*) if an individual, in respect of his own marriage or the marriage of any of his dependents, and

(*b*) if a Hindu undivided family, in respect of the marriage of the *karta* or any other member of the family, subject to a maximum of Rs. 5,000 for each marriage;

(4) four-fifths of any expenditure incurred by way of capital expenditure on the purchase of furniture and other household goods, motor-cars and other conveyances or any other articles for the personal use of the assessee or any of his dependents;

(5) any expenditure incurred by the assessee on the maintenance of his parents subject to a maximum of Rs. 4,000;

(6) any expenditure incurred by the assessee;

(*a*) if an individual, in respect of his own medical treatment or the medical treatment of any of his dependents or parents; and

(*b*) if a Hindu undivided family in respect of the medical treatment of the *karta* or any other member of the family, subject to a maximum of Rs. 5,000 in the case of an individual or a Hindu undivided family which consists only of the *karta*, his wife and children, and Rs. 10,000 in the case of any other Hindu undivided family:

Provided that the assessee may carry forward to the next year and the year immediately following any portion

of the said sum of Rs. 5,000 or Rs. 10,000 as the case may be, unexpended during any year;

Provided further that in the case of an assessee who immediately before the commencement of this Act has been incurring a higher expenditure on the medical treatment of himself or any of his dependents or his parents, the Expenditure Tax Officer may, in any of the five years commencing from the 1st day of April 1958, increase the allowance specified in this clause to such extent as he may think reasonable for that year, but so as not to exceed Rs. 20,000.

(7) any expenditure incurred by the assessee in respect of the education of himself or any of his dependents and where the assessee is a Hindu undivided family, of any member of the family in any country outside India, subject to a maximum of Rs. 8,000 per year;

(8) a basic allowance:

(*i*) where the assessee is an individual, of Rs. 30,000; and

(*ii*) where the assessee is a Hindu undivided family, Rs. 30,000 in respect of the *karta* and his wife and children, and a further allowance of Rs. 3,000 for every additional coparcener, provided that the basic allowance for the Hindu undivided family as a whole shall not exceed Rs. 60,000 in any case;

(9) any expenditure incurred by the assessee in any country outside India, in any case where he is not a citizen of India but is resident in India, to the extent to which such expenditure is not admissible under clause (3) or clause (5) or clause (6) or clause (7), subject to a maximum of Rs. 10,000.

(10) If the assessee proves in any year that in respect of any sum out of which any expenditure incurred is chargeable to tax under this Act he has paid in any foreign country any tax under any law for the time being in force in that country relating to taxes on income, wealth or expenditure, he shall be entitled to a deduction from the expenditure chargeable to tax under this Act of that portion of the tax paid in the foreign country as is attributable to the amount of such expenditure.

Assessment

Every person who is liable to expenditure tax shall before the 30th day of June of the corresponding assessment year furnish a return in the prescribed and verified form setting forth his expenditure for the previous year.

If the Expenditure Tax Officer is of the opinion that the expenditure of any person for any year is of such an amount as to render him liable to Expenditure Tax, he may serve a notice on such person requiring him to furnish in not less than 30 days a return of his expenditure in the prescribed and verified manner relating to the particulars of the expenditure of the person.

Expenditure-escaping Assessment

If the Expenditure Tax Officer:

(*a*) has reason to believe that by reason of the omission or failure on the part of the assessee to make a return of his expenditure under Section 13 for any assessment year, or to disclose fully and truly all material facts necessary for his assessment for the year, the expenditure chargeable to tax has escaped assessment for the year;

(*b*) has in consequence of any information in his possession reason to believe, notwithstanding that there has been no such omission or failure as is referred to in clause (*a*), that the expenditure chargeable to tax has escaped assessment for any assessment year, whether by reason of under-assessment at too low a rate or otherwise; he may, in cases falling under clause (*a*) at any time within four years of the end of that assessment year, serve on the assessee a notice containing all or any of the requirements which may be included in a notice under sub-section (2) of Section 13 and may proceed to assess or reassess such expenditure, and the provisions of the Act shall, so far as may be, apply as if the notice was issued under that subsection.

Penalty for Concealment

If the Expenditure Tax Officer is satisfied that (*a*) the assessee has without reasonable cause failed to furnish the return of his expenditure which he is required to furnish under

sub-section (1) or sub-section (2) of Section 13 or Section 16, or has without reasonable cause failed to furnish it within the time allowed and in the manner required; or (*b*) has without reasonable cause failed to comply with notice under sub-section (4) of Section 15; or (*c*) has concealed the particulars of any expenditure or deliberately furnished inaccurate particulars thereof, he may by order in writing, direct that such person shall pay by way of penalty;

(*i*) in the case referred to in clause (*a*), in addition to the amount of Expenditure Tax payable by him a sum not exceeding one and a half times the amount of such tax, and

(*ii*) in the case referred to in clause (*b*) or clause (*c*), in addition to the amount of Expenditure Tax payable by him a sum not exceeding one and a half times the amount of such tax, if any, which would have been avoided if the expenditure returned by such person had been accepted as correct.

Rates of Expenditure Tax

Under Section 3 of the Act the following tax shall be payable by every individual and Hindu undivided family on that portion of the taxable expenditure:

(*i*)	which does not exceed Rs. 10,000	10%
(*ii*)	which exceeds Rs. 10,000 but does not exceed Rs. 20,000	20%
(*iii*)	which exceeds Rs. 20,000 but does not exceed Rs. 30,000	40%
(*iv*)	which exceeds Rs. 30,000 but does not exceed Rs. 40,000	60%
(*v*)	which exceeds Rs. 40,000 but does not exceed Rs. 50,000	80%
(*vi*)	which exceeds Rs. 50,000	100%

§ 2. *GIFT TAX*

Theory of Gift Tax

Another important tax recently imposed is the gift tax. The case for the gift tax may be argued on grounds of equity, expediency and administration efficiency.

Property is passed on from generation to generation, either through inheritance or gifts and settlements. It is an accepted principle of Public Finance that the case for estate duty depends upon the security which the State provides in safeguarding property rights after the death of the owner. The justification for taxes on inheritance is that the community has the right to limit each individual's freedom to pass on his property intact to his successors. Progressive taxes can indeed be justified as a graduated limitation on the right to pass on ownership rights to others. If this is so there is no reason for differentiating between the right to pass on property through gifts and the right to pass on property by bequest. There is, therefore, a *prima facie* case for supplementing estate duties with taxes on gifts made *inter vivos* since the incidence of taxation should not differ with the mode or form through which property is transferred.

Another reason for the taxation of *inter vivos* gifts is that the imposition of the estate duty itself may stimulate *inter vivos* transfers of property to heirs and successors, so as to avoid the payment of estate duty. *Inter vivos* gifts are made on many occasions as for example—the marriage of children or grandchildren or when children reach maturity and set up a separate household or business. There is no reason why such gifts should be differently treated for purposes of taxation than gifts received through inheritance.

An attempt is usually made in the tax laws of different countries to limit the period of *inter vivos* settlements free for purposes of taxation. These provisions may carry the presumption that all gifts made within the prescribed period prior to death were made with the dominant motive of tax avoidance. Equity demands that the time factor should not be the basis for transfers of property free from taxes in some cases and taxable in others merely because the property is passed on after the death of the donor. A highly progressive estate duty is an incentive to the tax-payer to give a part of his estate with a view to reducing the liability to estate duty since in that case the tax is payable not only on a smaller portion of the estate which passes so on after his death but also through a lower rate of duty becoming applicable to

the remainder of the property. The more the State attempts to limit the scope for such tax avoidance by spreading the period prior to death during which gifts are made tax-free, observed Prof. Kaldor, the more arbitrary the incidence of the duty becomes and the greater the element of luck or ill-fortune in determining the liability of the tax.

Apart from reasons of equity, economic expediency also demands the imposition of a gift tax. The main justification for levying a steeply progressive tax whenever property passes from one generation to the next is to counter the tendency towards an increase in the concentration of wealth which is an inevitable consequence of economic progress in a society. If a rich man gives his estate, not to a single heir, but to a large number of beneficiaries he is thereby doing something himself to counteract that tendency by spreading his property among several persons. Moreover, when the rates of estate duty are very stiff (and they have to be stiff in the higher brackets to provide an effective antidote to the tendency of increasing concentration of wealth), the temptation of the rich to dissipate their capital during their lifetime (a temptation held in check in India at present by the loopholes in taxation of making gifts *inter vivos* free from taxation) must be pretty strong. This temptation undoubtedly will be less if a man could reduce his assets which would be taxed at death by spreading it among a large number of potential beneficiaries.

A gift tax would thus (*i*) introduce equity in the tax-structure by treating property equally in matters of taxation, whether the property is passed by gifts *inter vivos* or inheritance; (*ii*) check capital dissipation by reducing wasteful capital expenditure on a large number of occasions when gifts are made; (*iii*) bring additional revenue from the estate duties (which previously was not possible on account of heavy gifts) and (*iv*) introduce efficiency in the tax-structure.

Main Features of the Indian Gift Tax

The most important tax proposed by the Finance Minister in the budget for 1958-59 was the gift tax. The main incidents of the Gift Tax are briefly summarised as follows:

Charge of Gift Tax

Subject to the provisions of the Gift Tax Act, 1958, there shall be charged for every financial year commencing on and from the 1st day of April, 1958 a tax in respect of the gifts, made by a person during the previous year at the rate or rates specified in the Act.

Gift tax is payable by all persons (individuals, Hindu undivided families, companies, firms and associations of persons) making gifts taxable under the Act except (*a*) Government Companies (*b*) Corporations established by a Central, State or Provincial Act; (*c*) Public companies whose affairs are controlled by and a majority of the shares of which are held by six persons or more; (*d*) Subsidiary companies of the companies referred to in (*c*); and (*e*) Recognised charitable institutions or funds.

Exemption in respect of Certain Gifts

(1) Gift tax shall not be charged under this Act in respect of gifts made by any person:

(*i*) of immoveable property situated outside the territories to which this Act extends;

(*ii*) of moveable property situated outside the said territories unless the person:

(*a*) being an individual, is a citizen of India and is ordinarily resident in the said territories, or

(*b*) not being an individual, is resident in the said territories, during the previous year in which the gift is made;

(*iii*) of property in the form of savings certificates issued by the Central Government, which that Government, by notification in the Official Gazette, exempts from Gift Tax;

(*iv*) to the Government or any local authority;

(*v*) to any institution or fund established for a charitable purpose to which the provisions of Section 158 of the Income-Tax Act apply;

(*vi*) for any charitable purpose not falling within clause:

(*a*) made at any time before April 1, 1958 or

(*b*) made at any time after that date subject, in respect of each such gift, to a maximum of rupees one hundred

in value and, in respect of such gifts in any one previous year to the same donee, to a maximum of rupees five hundred in value in the aggregate;

(*vii*) to any relative dependent upon him for support and maintenance, on the occasion of the marriage of the relative, subject to a maximum of rupees ten thousand in value in respect of the marriage of each such relative;

(*viii*) to his or her spouse, subject to a maximum of rupees one lakh in value in the aggregate in one or more previous years,

(*ix*) of policies of insurance or annuities to any person (other than his wife) who is dependent upon him for support and maintenance, subject to a maximum of rupees ten thousand in value in the aggregate in one or more previous years of the benefits in respect of each such donee;

(*x*) under a will;

(*xi*) in contemplation of death;

(*xii*) for the education of his children, to the extent to which the gifts are proved to the satisfaction of the Gift Tax Officer as being reasonable having regard to the circumstances of the case;

(*xiii*) being an employer, to any employee by way of bonus, gratuity or pension or to the dependents of a deceased employee, to the extent to which the payment of such bonus, gratuity or pension is proved to the satisfaction of the Gift Tax Officer as being reasonable having regard to the circumstances of the case and is made solely in recognition of the services rendered by the employee;

(*xiv*) in the course of carrying on a business, profession or vocation, to the extent to which the gift is proved to the satisfaction of the Gift Tax Officer to have been made bona fide for the purpose of such business, profession or vocation;

(*xv*) to any person in charge of any such *Bhoodan* or *Sampattidan* movement as the Central Government may, by notification in the Official Gazette, specify;

(*xvi*) out of the sums, if any, guaranteed or assured by the Central Government as his privy purse, if the gifts are made for;

(*a*) the maintenance of any relatives dependent on him for support and maintenance; or

(*b*) for the performance of any official ceremonies;

Provided that such gifts are in accordance with the practice, usage or tradition of the family to which the person making the gift belongs.

(2) Gift tax shall not be charged under this Act in respect of gifts made by any person during the previous year, subject to a maximum of rupees ten thousand in value.

Value of Gifts, how Determined

(1) The value of any property other than cash transferred by way of gift shall be estimated to be the price which in the opinion of the Gift Tax Officer it would fetch if sold in the open market on the date on which the gift was made.

(2) Where a person makes a gift which is not revocable for a specified period, the value of the property gifted shall be the capitalised value of the income from the property gifted during the period for which the gift is not revocable.

(3) Where the value of any property cannot be estimated because it is not saleable in the open market, the value shall be determined in the manner prescribed in the Act.

Assessment

Every person who during a previous year has made any taxable gifts shall, before the thirtieth day of June of the corresponding assessment year, furnish to the Gift Tax Officer a return in the prescribed form and verified in the prescribed manner.

If the Gift Tax Officer is of opinion that in respect of the gifts made by a person during any previous year he is liable to gift tax under this Act, he may serve a notice upon such person requiring him to furnish within such period, not being less than thirty days, as may be specified in the notice, a return in the prescribed form and verified in the prescribed manner.

The Gift Tax Officer may in his discretion extend the date for the delivery of the return under this section.

Penalty for Default and Concealment

If the Gift Tax Officer, Appellate Assistant-Commissioner, Commissioner or Appellate Tribunal, in the course of any proceedings under this Act, is satisfied that any person:

(*a*) has without reasonable cause failed to furnish the return or has without reasonable cause failed to furnish it within the time allowed and in the matter required; or

(*b*) has without reasonable cause failed to comply with a notice;

(*c*) has concealed the particulars of any gift or deliberately furnished inaccurate particulars thereof; he or it may, by order in writing direct that such person shall pay by way of penalty:

(*i*) in the case referred to in clause (*a*), in addition to the amount of gift tax payable by him, a sum not exceeding one and a half times the amount of such tax, and

(*ii*) in the case referred to in clause (*b*) or clause (*c*), in addition to the amount of gift tax payable by him, a sum not exceeding one and a half times the amount of the tax.

Rebate of Advance Payments

(1) If a person making a taxable gift of the value of not less than rupees ten thousand pays into the treasury in the case of a taxable gift made before June 16, 1958, before August 1, 1958, and, in the case of any other taxable gift, within fifteen days of his making the gift he shall, be given credit in addition to the amount so paid, for an amount equal to ten per cent of the amount so paid.

(2) The amount to be paid into the treasury under subsection (1) shall be:

(*a*) where the value of the gift does not exceed rupees fifty thousand, four per cent of the value;

(*b*) where the value of the gift exceeds rupees fifty thousand but does not exceed rupees two hundred thousand, eight per cent of the value; and

(*c*) in any other case, fifteen per cent of the value.

Liability to Assessment in Special Cases

Where a person dies, his executor, administrator, or other legal representative shall be liable to pay out of the estate of the deceased person, to the extent to which the estate is capable of meeting the charge, the gift tax determined as payable by such person, or any sum which would have been payable by him under this Act if he had not died.

Gift Tax by whom Payable

Gift Tax shall be payable by the donor but where in the opinion of the Gift Tax Officer the tax cannot be recovered from the donor, it may be recovered from the donee;

Provided that the amount of the tax which may be recovered from the donee shall not exceed that portion of the gift tax which is attributable to the value of the gift made to the donee by the donor as at the date of the gift.

Gift Tax to be charged on Property Gifted

Gift tax payable in respect of any gift comprising immoveable property shall be a first charge on that property but any such charge shall not affect the title of bona fide purchaser for valuable consideration without notice of the charge.

Rates of Gift Tax

The rates of Gift Tax are given below:

On the first Rs.	50,000	4 per cent
On the next Rs.	50,000	6 per cent
On the next Rs.	50,000	8 per cent
On the next Rs.	50,000	10 per cent
On the next Rs.	1,00,000	12 per cent
On the next Rs.	2,00,000	15 per cent
On the next Rs.	5,00,000	20 per cent
On the next Rs.	10,00,000	25 per cent
On the next Rs.	10,00,000	30 per cent
On the next Rs.	20,00,000	35 per cent
On the balance		40 per cent

This tax came into effect from the financial year 1958-59.

The estimated yield of the expenditure tax and the gift tax during 1958-59 was Rs. 3 crores each.

XVI

CENTRAL EXCISE DUTIES

INTRODUCTORY

In the field of indirect taxation excise duties are taxes on expenditure. Excise duties in India are of two kinds:

(*i*) duties on alcohol, opium and hemp drugs; and

(*ii*) duties on home-produced goods. While the former duties are levied to check the consumption of harmful articles, the latter are primarily imposed for revenue considerations. Indeed they are generally regarded as purely consumption taxes.

Excise duties may be defined as taxes levied on home-produced commodities meant for local consumption. They are usually levied at the stage when the commodities are in the hands of the producer or the wholesale dealer; a draw-back is allowed if the commodities are subsequently exported. The incidence of the excise duties is on the consumer. But if the imports are the main factor in determining prices it is probable that the incidence of the duties may be on the producer.

Theoretically excise duties are justified in a poor country where the masses can only be taxed through indirect taxation on articles of common use. Besides, the imposition of equal excise duties and import duties is a sound method of indirect taxation in a country where the home industry does not require protection. Again, a combination of excise duty and import duty may raise prices by a lower amount than a single duty of either kind calculated to bring in the same revenue. To give an example, suppose it is necessary to raise a revenue of rupees one crore from an article of which the imports are worth Rs. 10 crores and the home production is of an equal aggregate value. Assuming that the home product and the imported articles are of identical qualities and the demand for the commodity is inelastic, the revenue could be raised from an import duty of 5 per cent combined with an excise duty of 5 per cent; in which case the price may rise in the

neighbourhood of 5 per cent. But if an excise or an import duty alone is levied, the duty would have to be at least as high as 10 per cent to bring in the above amount of revenue.

There are, however, some practical limitations in the levy of excise duties. Excise duties are not suited to small or scattered industries as the cost of collection in such cases may be unduly high and vexatious and the duties may not satisfy the Canon of Economy. Besides the duty is likely to press more heavily on a small producer than a large one. Hence if the duty is levied on commodities produced in large units as well as on a cottage industry basis, the rate of duty should be a lower one in the latter case. (This has been done in India in the case of excise duties on match and soap industries.) Again, the excise duties should not press too heavily on the poorer classes. This, however, may not be a practical possibility as the best revenue-yielders are commodities of general consumption in the nature of necessaries of life. The statesman in such cases has to strike a balance between the needs of the public treasury and the incidence of taxation on the masses. Broadly speaking, the case for excise duties may briefly be summarised as follows:

(1) Excise duties from an administrative point of view should ordinarily be levied on commodities which are produced in large factories or when the area of their production is a small one.

(2) Ordinarily they should be imposed for revenue purposes only.

(3) While imposed on necessaries of life, they should not press too heavily on the poorer classes; and finally

(4) When excise duties are imposed on an industry which requires protection, other things being equal, the tax should take the form of an excise duty *plus* an additional import duty. The latter should fully countervail the former and may even be fixed at a higher rate.

§ 1. *GROWTH OF EXCISE DUTIES*

Evolution of Excises

The first excise duty levied by the Government of India

(excepting the duty on salt) was on cotton yarn above twenty counts in 1894. In 1896 this was changed with an excise duty on mill cloth. Both these excise duties were the product of the controversy which raged during the last quarter of the nineteenth century relating to the import duty on cotton cloth from Lancashire. It was an ugly phase of Indian tariff and resulted in political agitation against excise duties. The Finance Commission (1921-22) reviewed the whole position and recommended the abolition of excise duty on cloth. The excise duty on cloth was abolished in 1926.

Of the excises in their present form the first to be levied was on motor spirit in 1917. The primary objective of the excise duty on motor spirit was to reduce its consumption and to conserve the reduced supply for war purposes. The duty has, however, been retained as a permanent feature and is now a substantial source of revenue. In 1922 an excise duty on kerosene was levied. The third article on which excise duty was levied was silver in 1930. The year 1934 is a landmark in the history of excise duties as in that year excise duties on sugar, matches, and steel ingots were imposed. All these three industries were established as a result of protection and it was thought desirable to levy an excise duty on them to recover the loss in revenue which the exchequer had suffered on account of protection.

The really important development in excise duties came during the Second World War when all possible taxes were imposed to finance the War. In 1941 an excise duty on tyres was imposed.[1] In 1943 vegetable products and tobacco were brought under excise. The excise duty on tobacco was not in conformity with one of the recommendations of the Fiscal Commission (1921-22) viz. that the excise duty was to be levied only on products of organised industries from which collection was easy and evasion difficult.[2]

In 1944 an excise duty on coffee, tea and betel-nuts was imposed. The duty on betel-nuts was abolished in 1948,

[1] The tyre industry is another example where the excise duty was levied to recover the loss of customs revenue through the replacement of imports by home production.

[2] The taxation of tobacco necessitated an elaborate scheme of taxation which is described in greater detail on pp. 309-12.

primarily on account of administrative difficulties and also because the betel-growing areas were included in Pakistan.

Perhaps the most important addition to the Central excise schedule was made in 1949 when an excise duty on mill-made cloth was imposed. After independence the salt tax wax abolished and the excise duty on cloth was justified to recover the loss in revenue from the abolition of the salt tax. Besides, it was pointed out that the excise duty would also help the handloom industry. In 1954 duties on art silk, cement, soap and footwear were imposed.

The following table gives the revenue from excise duties as a percentage to the total gross revenue of the Government of India.

TABLE LIX

REVENUE FROM EXCISE DUTIES AS PERCENTAGE OF TOTAL TAX REVENUE

(In crores of rupees)

Year		Total Tax Revenue	Central Excise Revenue	Excise Revenue as percentage of total tax revenue
1920-21	..	60.85	2.85	4.7
1925-26	..	72.86	3.21	4.4
1931-32	..	75.62	6.19	8.2
1938-39	..	81.37	8.72	10.7
1948-49	..	371.70	50.63	13.6
1949-50	..	350.39	67.85	19.4
1950-51	..	410.66	67.54	16.4
1951-52	..	459.99	85.78	18.6
1952-53	..	387.06	83.03	21.5
1953-54	..	363.28	94.98	26.1
1954-55	..	399.26	108.22	27.1
1955-56	..	428.04	145.25	33.9
1956-57[1]	..	494.76	190.43	38.5
1957-58[2]	..	592.00	252.45	42.6

[1] Revised Estimates.
[2] Budget Estimates including effect of budget proposals.
Figures up to 1938-39 are gross revenue; for subsequent years they are net figures.

The two important principles underlying the extension of excise duties during the period (1934-56) were that (*i*) the indigenous industries which had developed under protection should be taxed to replace the loss in import duty; and (*ii*) to broadbase the country's tax-structure.

There have been three important factors which have affected the total revenue from excise duties. They are (1) changes in rates; (2) increase in quantities consumed; and (3) increase in coverage by bringing a larger number of commodities under taxation. The Taxation Enquiry Commission (1953-54) closely examined the influence of each of these factors and came to the conclusion that extension of coverage was more important than increase in rates of duties from the revenue standpoint. It is significant to point out that during 1953-54 only 29 per cent of the revenue from excise duties was realized from articles which were subject to excise duties during 1938-39 and 76 per cent from articles which were taxed in 1948-49. The influence of increased consumption on the yield of excise duties was roughly speaking 25 per cent during 1938-39 and 1948-49 and 27 per cent during 1948-49 and 1953-54. Finally, if account is taken of the rise in the price level it will appear that the rise in rates of duty has been very moderate. Thus between 1938-39 and 1953-54 while the price level increased four-fold, the increase in revenue due to increase in rates of duties was 125 per cent.

Broadly speaking, it may be observed there is considerable scope for the utilization of excise duties especially because domestic production has replaced imports to a large extent and the revenue from customs has not much scope for any appreciable increase. Besides, the increase in specific rates of duty has been very moderate in relation to increase in price level.

§ 2. *EXCISES ON PRINCIPAL COMMODITIES*

Excise Duty on Tobacco

Having briefly surveyed the evolution of excise duties we now give a somewhat more detailed account of the excise duties on some of the principal commodities. The possibility

of taxation on tobacco was considered on several occasions but administrative difficulties always stood in the way of imposition of the tax. The Taxation Enquiry Committee (1924-25) observed that 'the absence of any internal taxation on tobacco is a feature which distinguishes the fiscal system of India from that of almost every other civilised country of the world.' The Committee was of opinion that in view of the widespread consumption there was a strong case for the taxation of tobacco in India.

India is the third largest producer of tobacco in the world coming next after the U.S.A. and China. The area under tobacco cultivation has increased rapidly during recent years; it rose from 5.7 lakh acres in 1946-47 to 10.2 lakh acres in 1952-53. Among cash crops, tobacco occupies an important place ranking after sugar-cane, ground-nuts and cotton. The value of the output of tobacco was Rs. 71 crores in 1950-51. Tobacco is also an important item of export being eighth in order of value.

The Taxation Enquiry Committee considered the following four methods by which tobacco could be taxed in India viz:

(1) a Government monopoly;
(2) an acreage fee;
(3) a regular excise system; and
(4) a system of licences.

The possibility of a Government monopoly was ruled out as the area under cultivation was too vast and could not be efficiently administered. Similarly a system of acreage fee was also considered to be administratively difficult because of scattered cultivation and large variations in the yield of the crop. The Committee, therefore, had suggested a combination of a regular excise system for cigarettes, smoking tobacco, and cigars manufactured in organized factories, combined with a system of licensing for the taxation of other forms of tobacco.

An excise duty on tobacco was imposed for the first time with effect from April 1, 1943. Graduated rates were fixed for flue-cured tobacco used in the manufacture of cigarettes depending on the imported tobacco content of the blends.

They ranged from eight annas per lb. to Rs. 1-12-0 per lb. For non-flue-cured tobacco used in the manufacture of cigarettes the rate of duty was fixed at six annas per lb. and the same rate was also fixed for tobacco used for *biris* and snuff.

A lower rate of two annas per lb. was fixed for cigar and cheroot tobacco and a still lower rate of one anna per lb. was fixed for *hookah* and chewing tobacco and stalks. In addition to the duty on the tobacco used in the manufacture of cigars and cheroots a graduated duty on the basis of value slabs was imposed on the higher grades of manufactured cigarettes and cheroots.[1]

In the beginning there were great administrative difficulties in the working of the excise duty. However, with the improvement in the administrative machinery the rates of duty were considerably increased in 1944. The rates of duty on flue-cured tobacco used for the manufacture of cigarettes were doubled, ranging from Re. 1-0-0 to Rs. 3-8-0 per lb.; the rates for non-flue-cured tobacco used for cigarettes as well as *biri* and snuff tobacco were raised by 50 per cent to nine annas per lb. and the rates for cigar and cheroot, *hookah* and chewing tobacco were raised to a uniform level of three annas per lb. As a result of these changes the revenue rose from Rs. 9.65 crores in 1943-44 to Rs. 17.28 crores in 1944-45.

In 1945, the rates of duty on flue-cured tobacco used in the manufacture of cigarettes in admixture with imported tobacco were graduated further and rates of Rs. 7-8-0 and Rs. 5-0-0 per lb. were imposed on the classes of cigarettes containing over 60 per cent and between 40 per cent and 60 per cent respectively of imported tobacco in the blends. These changes raised the revenue to Rs. 20.82 crores in 1945-46.

In 1951, the rate of duty on *biri* tobacco was raised to fourteen annas per lb. and the rate for cigar and cheroot, *hookah* and chewing tobacco was raised to six annas per lb. Snuff tobacco was also classified with the latter and, consequently, the rate of duty for it was reduced from twelve annas to six annas per lb. Surcharges at rates of one pice and two pice per ten cigarettes were also imposed on cigarettes with retail

[1] See *Report of the Taxation Enquiry Commission*, Vol. II, p. 261.

price for ten cigarettes between two annas and five annas six pies and exceeding five annas six pies respectively.

The subsequent changes in rates of duties are stated elsewhere.

Coffee

The excise duty on coffee was introduced in 1944; the rate of duty was fixed at 2 annas per lb. In 1945 the rate of duty was raised to 3 annas per lb. The quantity cleared for consumption had increased from 27 million lbs. in 1945-46 to 42 million lbs. in 1953-54; the revenue had also increased during the above period from Rs. 34 lakhs to Rs. 79 lakhs.

Tea and coffee are rival commodities from the point of view of consumption. It has been observed that the rate of duty of 3 annas per lb. discriminates consumers of coffee as against tea for it makes the incidence of the duty per cup of coffee higher than that on tea. However, from the point of view of price the duty on coffee bears about the same percentage to wholesale price as the duty on package tea.

Motor Spirit

The excise duty on motor spirit, as already pointed out, was introduced in 1917. The rates of duty were changed on a number of occasions to realize a large amount of revenue. The rate of duty was 6 annas per imperial gallon during the period 1917 to 1925; the revenue realized increased from Rs. 24 lakhs in 1917-18 to Rs. 79 lakhs in 1924-25. The duty was reduced to 4 annas per gallon in 1925 when the customs import duty was also made equal to the excise duty. The rate of 4 annas remained in force during the period 1927-29. In 1929 the revenue was Rs. 1.55 crores. In 1929-30 the duty was again raised to 6 annas per gallon and the revenue in 1929-30 was Rs. 2.81 crores. With the increase in the rate of duty to 8 annas per gallon from April 1, 1931, and to 10 annas per gallon with effect from September, 1931 the revenue reached the peak figure of Rs. 5.59 crores in 1936-37. With the separation of Burma in 1937, there was a sharp decline in revenue to Rs. 1.36 crores in 1937-38 and thereafter the customs revenue became more important than the excise

revenue. During 1940 the rate was increased to 12 annas per gallon. In 1942 it was again increased to 15 annas per gallon. In 1946 the rate was reduced to 12 annas per gallon but in 1948 it was again raised to 15 annas per gallon. In 1951 there was again a customs surcharge of 5 per cent and with it the duty was raised to 15 annas and 9 pies per gallon.

The future of the excise duty depends upon the indigenous output which is linked with the working of refineries in India. In future the Central revenue from motor spirit will be derived mainly from excise duty instead of customs duty.

Kerosene

There have been frequent changes in the excise duty on kerosene. The duty was imposed for the first time in 1922 at the rate of one anna per gallon. In 1930 the rate was raised to one anna and 6 pies per gallon, in 1931 to 1 anna and 3 pies per gallon and again during the course of the same year from September 20, 1931 to 2 annas and nine pies per gallon. The next important increase came in 1942 when the rate was increased to 4 annas 6 pies per gallon. From 1946, as tax relief to the poorer sections of the community by whom kerosene is mostly used, the rate of duty was reduced to 3 annas per gallon.

The revenue from excise duty on kerosene may increase in future as a result of the working of the refineries in India.

Sugar

The import duty on sugar was an important item of customs revenue. In 1930-31 it amounted to Rs. 10.8 crores. With the development of the indigenous sugar industry under a protective tariff the revenue from import duty was reduced considerably and it was necessary to meet the loss in revenue by imposing an excise duty on indigenous sugar. An excise duty on indigenous sugar was imposed in 1934 at the rate of Rs. 1-5-0 per cwt. This rate remained in force for the period 1934-37. The rate of duty was raised to Rs. 2 per cwt in 1937; in 1940 it was further raised to Rs. 3 and in 1949 to Rs. 3.12 per cwt.

The excise revenue from sugar rose from 1.53 crores in

1935-36 to Rs. 14.33 crores in 1953-54 and to Rs. 37.62 crores in 1957-58 and Rs 42·00 crores in 1958-59.

The incidence of the excise duty is not heavy on the middle class of the community. This perhaps is evident from the increase in sugar consumption which rose from 7.2 lakh tons in 1947-48 to 15.7 lakh tons in 1953-54. Besides the duty expressed as a percentage of wholesale price has fallen from 21 in 1940-41 to 9 in 1953-54. The Taxation Enquiry Commission was of the opinion that there was a case for a substantial increase in the rate of duty.

Matches

The Taxation Enquiry Committee (1924-25) had recommended the levy of an excise duty on matches. The excise duty on matches was imposed in 1934 at the rate of Re. 1 per gross for boxes of 40 sticks, Rs. 1-8-0 for 50 sticks and Rs. 2 for 80 sticks.

To safeguard the position of manufacturers of matches in cottage industries, units producing not more than 100 gross boxes per day were given a rebate of 10 pies for 40 stick-boxes, 15 pies for 60 sticks, and 20 pies for 80 sticks. These concessions were, however, less than the rebate of 2 annas as recommended by the Tariff Board.

The rates of duty as fixed in 1934 remained in force up to 1941 when they were doubled to raise additional revenue. In 1941 a new tariff class of 50 sticks was also introduced on which the rate of duty was Rs. 2-8-0 per gross.

In creating a tariff class of 60 sticks, the intention was to raise the price of a match box to 2 pice; in actual practice however, this was not found practicable. Hence the duty was reduced with effect from August 1, 1951, on 50 stick-boxes to Rs. 1-12-0 per gross, leaving the rates on other classes unaltered. This change in tariff schedule meant a higher rate of duty (Rs. 2-0-0) on a box of 40 sticks, the object being to encourage the standardisation of production of 50 stick-boxes. But as 50 stick-boxes could not be sold at 2 pice, from March 1, 1945 the rate of Rs. 2-8-0 per gross of 50 sticks was again restored.[1]

[1] See *Report of Taxation Enquiry Commission*, Vol. II, p. 305.

There was much confusion in the incidence of the tax both on consumers as well as producers of cottage factories, because of the imposition of duty at different rates on different types of match boxes. Besides, the consumers were also exploited as boxes with small match-sticks were put on sale as boxes containing more sticks. In 1948-49 the question of standardisation of match-production was examined but because of various difficulties (especially from match companies) it could not be adopted. In 1949 further preferential treatment was given to medium-size factories as a result of which factories whose output did not exceed 500,000 gross boxes per year but exceeded 100 gross boxes per day were granted rebates of 6 pies for 40 stick-boxes and 9 pies for 60 sticks and factories with output not exceeding 100 gross per day were given rebate of one anna for 40 sticks and 2 annas for 60 sticks. These concessions were further liberalised in 1950 when rebates were further increased to one anna for 40 sticks and one-and-half annas for 60 sticks in respect of factories in the intermediate range of output and 2 annas for 40 sticks and 3 annas for 60 sticks in respect of the low-output factories. The excise revenue from matches was about Rs. 2 crores in 1935-36, Rs. 9.35 crores in 1952-53, Rs. 8.73 crores in 1953-54 and Rs. 14.30 crores in 1957-58.

The duty of Rs. 2 per gross of 40 sticks and Rs. 3 per gross of 60 sticks comes roughly to 49 per cent of the wholesale and 44 per cent of the retail prices. The *per capita* incidence is about 4 annas. This may appear to be rather high. The Taxation Enquiry Commission was of opinion that as the bulk of the consumption is for smoking the excise rates should be further increased.

Tea

The excise duty on tea was introduced in 1944. The rate of duty from 1944 to 1948 was 2 annas per lb. when it was raised to 3 annas per lb. As a result of the steep fall in prices in the tea industry in 1952, the Government of India appointed a Commission which, among other measures of relief, recommended deferred payment of duty. The Commission did not recommend any reduction of excise duty. Later on the

Government decided to readjust the pattern of duty by imposing a low rate of one anna per lb. on loose tea when it left the producing factories in the gardens and a further higher levy of 3 annas per lb on issue from the packing factories after blending and packing into retail sizes. This change was introduced from April 15, 1953. The change conferred upon the gardens a saving of 2 annas per lb on all tea issued by them in loose form which was defined as 'issues in containers exceeding 60 lbs'. The revised pattern of duty caused a loss of over Rs. 1 crore in revenue in 1953-54. The actual excise revenue in 1957-58, 1958-59 and 1959-60 was Rs. 3.86 crores, Rs. 6.20 crores and Rs. 6.80 crores respectively.

The duties of one anna and four annas per lb on loose tea and package tea respectively represented 4.2 per cent and 8.6 per cent of wholesale prices (1953-54).

Cloth

The excise duty on cloth is one of the most important sources of revenue. It was introduced in 1949. A duty of 25 per cent *ad valorem* was imposed on superfine cloth (i.e. cloth with warp counts 48 or above) with effect from January 1, 1949 as one of the measures to combat inflation. The excise duty was further extended to cover fine, medium, and coarse varieties through the Finance Act, 1949. The rate of duty was 62 per cent *ad valorem* on fine cloth, 3 pies per yard on medium and coarse varieties.[1] The duty is confined to mill-made cloth and is not applicable to cloth woven on hand-looms. Similarly, cloth produced on power-looms, i.e. mills which do not have spinning departments, is also exempt from the duty.

The rates of duty were reduced with effect from February, 1950 on superfine and fine varieties to 20 per cent *ad valorem* and 5 per cent *ad valorem* respectively. The *ad valorem* duty was converted into yardage duty under the Finance Act, 1953; the rates of duty were fixed at 3 annas 3 pies per yard on superfine cloth and 1 anna 3 pies per yard on fine cloth.

[1] 'Fine' cloth was defined as cloth with warp counts 35 s–47 s; 'Medium' cloth as cloth with warp counts 35 s–34 s; and 'Coarse' cloth as cloth with warp counts not exceeding 16 s.

No change however, was made in the rates of duty on medium and coarse varieties which remained at 3 pies per yard. To encourage the production of *khadi* and other handloom cloth an additional flat rate duty of 3 pies per yard on all dutiable cloth was imposed with effect from February 15, 1953, the proceeds of the duty were earmarked for *khadi* and handloom industries. The duty on superfine cloth was reduced from 3 annas 3 pies to 2 annas per yard from October 25, 1953. In 1954 the rate of duties on superfine cloth was raised to 2 annas 6 pies per yard, that on fine to 1 anna 6 pies per yard and that on medium and coarse to 6 pies per yard.

The revenue from excise duty on cloth in some years is given in the following table:

(In crores of rupees)

Year				Revenue
1949	..	..	..	13.21
1950-51	..	..	..	9.81
1951-52	..	..	..	16.33
1952-53	..	..	..	13.43
1953-54	..	..	..	21.67
1954-55	..	..	..	27.59
1955-56	..	..	..	28.18
1956-57	..	..	..	51.86
1957-58	..	..	..	61.49
1958-59	..	..	..	58.56

Miscellaneous Excise Duties

In the miscellaneous range of excise duties mention may be made of excise duties on rayon or artificial silk fabrics, cement, soap and footwear. In the Budget for 1954-55, excise duties were imposed for the first time on rayon or artificial silk fabrics. The rate of duty is 6 pies per square yard, subject to an additional levy of 3 pies per yard which is earmarked for the benefit of *khadi* and other handloom industries.

The excise duty on cement was also imposed for the first time in 1954-55 and the rate of duty was Rs. 5 per ton. The yield from the duty was Rs...in 1957-58. The duty on soap was imposed in the Budget 1954-55. A rate of Rs. 14 per cwt

was fixed for toilet soap and lower rates of Rs. 5-4 per cwt and Rs. 6 per cwt was fixed on household and laundry soap in plain bars of not less than one pound in weight and 'other sorts' respectively. Soap produced by factories not using power and by factories using power, but whose output during a financial year does not exceed 100 tons of household and laundry soap and 50 tons of other soap, is exempt from duty. The revenue from the excise duty on soap was Rs. 1.76 crores in 1957-58. The duty forms roughly 7 to 10 per cent of the wholesale price.

The duty on footwear was also introduced in 1954-55 at 10 per cent *ad valorem*. Shoes manufactured by factories not using power and by factories using power not exceeding two horse-power and employing less than 50 workers are exempt from duty.

XVII

CUSTOMS REVENUE

Commodity taxation in India consists of import duties, export duties and excise duties. In this chapter an account of the import and export duties will be given.

§ 1. *GROWTH OF CUSTOMS REVENUE*

Since 1920-21 the revenue from customs has formed an important part of the total tax revenue of the Central Government. A substantial expansion in the field of customs revenue took place between 1920-21 and 1925-26 due primarily to the development of the import tariff. This was primarily due to the changes in the import tariff between 1920-26. During the period 1925-39 there was little change in import duties. Indeed the loss in import duties during the depression period was made up for by the imposition of excise duties and the enhanced rates of salt tax. The contribution of customs to the Central revenue almost reached the level of 1925-26 by 1938-39. After 1948-49 a considerable increase in the import revenue took place due to an increase in rates of import duties and the growth in the volume of imports. Table LX shows the share of customs revenue to the total revenue of the Government of India.

Evolution of Import Tariff

At the end of World War I, the general rate of import duty was 7 per cent with machinery and iron and steel paying at 2½ per cent; sugar at 10 per cent and motor spirit at 6 annas per gallon. Because of financial needs the general rate was increased to 11 per cent in 1921 and again to 15 per cent in 1922. In addition, matches and luxury items were subjected to higher rates of duty. In 1922 a new duty of 5 per cent was imposed on cotton yarn. The duty on iron sheet and railway materials was 10 per cent. These rates remained practically unchanged up to 1931 except those which were

TABLE LX

SHARE OF CUSTOMS IN CENTRAL GOVERNMENT TAX REVENUE

(In crores of rupees)

Year		Total Revenue of the Government of India	Customs Revenue	Customs Revenue as percentage of Total Tax Revenue
1920-21	..	60.85	29.05	47.74
1925-26	..	72.86	45.61	62.60
1931-32	..	75.62	41.53	54.92
1938-39	..	81.87	44.51	54.37
1948-49[3]	..	385.18	130.42	33.86
1949-50	..	311.54	124.71	40.03
1950-51	..	357.00	157.15	44.02
1951-52	..	459.99	231.69	50.37
1952-53	..	387.06	173.75	44.89
1953-54	..	363.28	158.71	43.69
1954-55	..	399.26	184.86	46.30
1955-56	..	428.04	166.70	38.94
1956-57	..	494.76	173.23	35.01
1957-58	..	725.80	179.99	24.80
1958-59[1]	..	728.20	136.00	18.68
1959-60[2]	..	780.86	130.00	16.65

[1] Revised Estimates.
[2] Budget Estimates including effect of Budget proposals
[3] Figures till 1948-49 are gross receipts; for subsequent years the figures are net receipts.
Source: Eastern Economist, Special Budget Issue, 1959-60.

altered for protective purposes. During the period 1922 to 1931 duties on sugar, unmanufactured tobacco, cotton piece-goods, and kerosene were raised and duty on silver was re-introduced.

The great depression of 1931 resulted in a heavy deficit in the Central Budget and hence additional taxation was introduced in the Indian Finance Act, 1931 and the Indian Finance (Supplementary and Extending) Act, 1931. The general rate of import tariff was increased up to 25 per cent; varying rates of surcharges were imposed on individual items like liquors, silver, sugar, spices, cotton piece-goods, tobacco, fuel and lubricating oils, motor cars, motor cycles, art silk

yarn and thread, art silk piece-goods and others. The changes introduced by the two Finance Acts of 1931 were incorporated in tariff from January 1, 1935 by the Indian Tariff Act, 1935.

In the year immediately preceding World War II the rates and duty on several items were raised, notably on raw cotton (1939), and art silk yarn and thread (1941). The former had a duty of half an anna per pound imposed in 1931 which was doubled in 1939 and by the Cotton Fund Ordinance, 1942, this rate was redoubled.[1] An overall surcharge of one-fifth on all duties was imposed by the Finance Act, 1942, this surcharge was continued from year to year until 1951. Besides certain permanent adjustments were made in the rates of duty on commodities on which there was no surcharge of duty; the duty on motor spirit (both custom and excise) was raised from 12 annas to 15 annas per gallon. In 1944, the rate of surcharge on certain portable spirits and cigars, cigarettes and tobacco was increased from one-fifth to one-half. In 1945, the duties on all tobacco items were refixed so as to correspond with the enhanced rate of Central excise on indigenous tobacco which were fixed in that year. In 1946, certain duties were readjusted and the duty on kerosene was substantially reduced from 4 annas 6 pies to 3 annas per gallon. Another important change was the conversion of the *ad valorem* duties on betel-nuts and cinematograph films by specific duties. The duty on silver was enhanced while gold was subjected to a duty for the first time, the rate was Rs. 25 per tola (this rate, however, was reduced by one-half by subsequent notification).

Certain important changes took place in tariff rates in 1948. These were due to some extent to the commitments entered into by India under GATT. The duty on industrial plant and machinery was reduced from 10 per cent to 5 per cent. Similarly duties on a number of raw materials for industries were either reduced or removed. By an Ordinance promulgated in November, 1948, the rates of duty on a number

[1] Under the provisions of the Ordinance, one anna of the duty went into the Fund. In 1946 the Fund was abolished leaving the revenue duty itself at 2 annas per lb.

of luxury items were substantially increased, e.g. articles of gold and silver, fine and superfine varieties of textiles, fireworks, toilet requisities, motor cars, crockery, cutlery, tobacco, alcoholic liquors. In 1950, the rates of duty on parts and accessories of motor vehicles were rationalised.

The next important series of changes in the import schedule were brought about under the Finance Act, 1951, after the outbreak of the Korean War. The general surcharge of one-fifth on import duties was enhanced to one-fourth. The rate of surcharge on liquors which was fixed at 100 per cent under the 1948 Ordinance was enhanced to 155 per cent. The finer varieties of textiles were subjected to a surcharge of 55 per cent. The specific rates of duty on mineral oils other than kerosene and motor spirit were replaced by specific rates to keep pace with the rise in import prices. In the Finance Act of 1953, substantial increase in the rates of duty was made on a number of consumer goods. But reliefs were granted in the duties on milk foods for infants or invalids, patent foods for infants and invalids, penicillin in bulk, antibiotics, sulpha-drugs, scientific and surgical instruments and art works. Under the Finance Act, 1954, the duty on betel-nuts was further enhanced, the preference in favour of the U.K. in respect of motor cars was abolished and anti-malarial drugs were subjected for the first time to a duty of 25 per cent *ad valorem*. Besides, duties on a number of items were en-enhanced.

The following table gives the revenue from imports duties as a percentage of total tax revenue

TABLE LXI

SHARE OF IMPORT DUTIES IN TOTAL CUSTOMS REVENUE

(In crores of rupees)

Year		Total revenue of the Government (net)	Total revenue from Imports (net)	Percentage of imports to total customs
1951-52	..	459.99	141.59	30.78
1952-53	..	387.0	118.07	30.51
1953-54	..	363.28	119.60	32.92

TABLE LXI (*Continued*)

Years		Total revenue of the Government (net)	Total revenue from Imports (net)	Percentage of imports to total customs
1954-55	..	399.26	141.06	35.33
1955-56	..	428.04	131.06	30,62
1956-57	..	494.76	127.98	25.87
1957-58	..	725.80	150.94	20.80
1958-59[1]	..	728.20	112.57	15.46
1959-60[2]	..	780.86	110.62	14.16

[1] Revised Estimates.
[2] Budget Estimates.
Source: *The Eastern Economist*, Special Budget Issue, 1959-60.

EXPORT DUTIES

§ 2. *GROWTH OF EXPORT DUTIES*

In the early years of British rule export duties were levied at small *ad valorem* rates on many articles of export. In some cases these duties seriously affected the exports, e.g. duties on indigo and salt-petre. Soon after the passing of the Company to the Crown in 1857, most of the export duties were abolished. In 1914, just on the eve of the First World War, there was an export duty on rice. The export duty on jute was imposed for the first time in 1916 and has ever since occupied an important place in the tariff schedule. A duty on raw hides and skins at 5 per cent *ad valorem* was imposed in 1919 but was abolished in 1935. During the Second World War an export duty of 3 per cent *ad valorem* was imposed on cotton cloth and yarn but in 1945 it was converted into an export cess. The yield from the export duties was between Rs. 4 to Rs. 6 crores during the period 1919-46.

Export duties during recent years have again occupied fresh importance in the fiscal system, as since 1946 they have been levied on a number of additional articles and the rates of the old duties have also been increased. In the following table the revenue from the export duties and their percentage to gross customs revenue is shown:

TABLE LXII

SHARE OF EXPORT DUTIES AS A PERCENTAGE OF TOTAL REVENUE

(In crores of rupees)

Year		Total revenue of the Government of India (net)	Total revenue from Exports	Percentage of exports to total customs revenue
1951-52	..	459.99	90.74	19.73
1952-53	..	387.06	55.97	14.46
1953-54	..	363.28	38.53	10.61
1954-55	..	399.26	41.37	10.36
1955-56	..	428.04	37.76	8.82
1956-57	..	494.76	27.70	5.60
1957-58	..	725.80	26.83	3.70
1958-59[1]	..	728.20	21.73	2.98
1959-60[2]	..	780.86	17.88	2.29

[1] Revised Estimates.
[2] Budget Estimates.
Source: *The Eastern Economist*, Special Budget Issue, 1959-60.

The yield from export duties reached the peak figure of Rs. 91 crores in 1951-52 when it formed nearly 40 per cent of the total customs revenue. In 1953-54 the yield was reduced to Rs. 38.5 crores, nearly 25 per cent of the total customs revenue. In 1957-58 its yield was Rs. 28.70 crores.

Export duties have been levied in India for revenue for three purposes:

(*i*) preventing the impact on domestic markets of the inflationary conditions in foreign markets; (*ii*) stablising domestic prices; and (*iii*) protection.

Among the important items of export on which the duty has been imposed, mention may be made of raw jute and jute manufactures, tea, manganese ore, cigarettes and cheroots, cotton piece-goods, black pepper, raw wool, oil-seeds, raw cotton and cotton waste and mercury.

The question of the levy of export duties was for the first time scientifically examined by the Indian Fiscal Commission in 1921-23 which, though it did not disapprove their levy, urged caution in using them. The Commission observed

that export duties may be justified if they fall mainly on foreigners and did not adversely affect the production of commodities in India. In other words they favoured an export duty primarily on articles in which India had a monopoly or semi-monopoly. The duty, however, should be a moderate one.

In view of the variety of purposes for which export duties have recently been imposed, a word of caution is necessary. Export duties may create special problems under uncertain conditions of international trade; especially the psychological reactions of the importers may make them unwelcome. However, they may be levied judiciously for revenue purposes only. The future of export duties is rather uncertain in view of the recent trends in the course of international trade.

Trends in Customs Revenue

From the account given in the foregoing pages it will appear that there have been three important periods in the evolution of customs revenue: (*i*) 1920-21 to 1925-26; (*ii*) 1931-32 to 1938-39; and (*iii*) 1948-49 to 1956-57. The first period was marked by a substantial growth in customs revenue; the two important factors which marked the development of the import tariff were raising the rates of the revenue duties and the grant of protective duty on some commodities as a result of the recommendations of the Indian Fiscal Commission (1921-22). As a result of these two factors the contribution of import duties to Central tax revenue increased from 38 per cent to 54 per cent.

The great depression of 1929 had an important effect on customs revenue. As a result of the increased burden of specific duties due to the fall in prices, the incidence of import duties increased from 17 per cent (1925-26) to 31 per cent in 1931-32. But owing to a fall in the value of imports the percentage of customs to Central tax revenue was reduced to 48 per cent. In 1938-39 the incidence of customs revenue was 25 per cent and the contribution to the total tax revenue was 49 per cent.

By 1948-49 the importance of customs revenue was very much reduced; the percentage of customs to the total tax revenue was reduced from 49 per cent (1938-39) to 25 per cent in 1948-49. This marked fall in customs revenue was

mainly due to the changes in tariff rates (made with a view to promote industrialisation) and changes in the composition of imports. The higher rates for luxury goods could not make up the loss in revenue due to these two causes. In 1953-54 there was a slight improvement in the position of the customs revenue; the percentage of import duties to the total tax revenue had increased to 29 per cent.

The fluctuations in the yield from import duties have closely followed the recent changes in the composition of import trade. Since World War II, (especially during the past few years) the large imports of foodgrains which are free of duty, have reduced the incidence of the import duties to the value of imports. In 1938-39 only 8.8 per cent of the value of total imports was accounted for by foodgrains; the corresponding percentages for 1948-49, and 1956-57, were 18.2, 13.1 and 00.0 respectively. A much more significant change in the composition of imports has been the large value of imports for the industrial requirements of the country as opposed to finished goods.

The import of industrial requirements such as raw cotton, motor spirit (for industrial purposes) machinery, building and engineering materials, tools and implements has considerably increased. It was 54 per cent in 1938-39 and 68 per cent in 1953-54 to the total volume of imports. Since the range of duties on such items is lower than that on finished goods, there has been an overall reduction of the revenue from import duties.

International Commercial Agreements

A passing reference to the influence of international commercial agreements on the volume of customs revenue may be made in concluding this section. The General Agreement on Tariffs and Trade and the Indo-British Trade Agreement (1939) have influenced the total yield of import revenue. Under GATT India has agreed to reduce duties on commodities, the total value of which was Rs. 85 crores in 1952-53; the articles on which such concessions were granted were 19 per cent of the total value of imports during that year. Besides, as Indian tariff does not contain a 'most favoured nation' clause the concessions have also been extended to non-GATT countries. The effective concessions are

mostly in the field of consumer goods. It must, however, be kept in view that these concessions granted by India were balanced by concessions which covered a large part of her exports; in 1952-53 the volume of exports effected by such concessions was 79.6 per cent of total exports. The concessions were mostly on commodities the demand for which was elastic and in which there was considerable competition. Thus U.S.A. reduced duties on mica, cashew-nuts and various jute items. It has been estimated that as a result of these concessions the loss in revenue was about 85 lakhs in relation to a total value of Rs. 120.4 crores of imports. The Fiscal Commission (1949-50) was of opinion that India should adhere to GATT, primarily in view of the need for international economic co-operation. In view of the present difficulties in the foreign exchange position and the drastic policy of import control followed by the Government the revenue significance of GATT may be rather small. However, the probable loss in revenue due to GATT must always be balanced against the need for international economic co-operation.

The second important international commercial agreement which affect customs revenue is Commonwealth Preference. It has its origin in the Ottawa Agreement which later on was revised by the U.K.-India Trade Agreement, 1939. Under this system, Commonwealth Preference for India takes the form of guaranteeing to the U.K. and certain Colonies margins between the rates of duty payable on their exports to India, and duties levied on goods imported into India from other countries. The Taxation Enquiry Commission estimated the loss in revenue from these preferences at Rs. 3.5 crores—Rs. 2.6 crores on imports from the U.K. and Rs. 0.9 crores on imports from the Colonies. It is difficult to forecast the future effect of these international agreements on customs revenue. However, it is safe to infer that though the imports of consumer goods may decline during the transitional period in the present economic development of the country, the quantum of imports of consumer goods is bound to increase with the growth in the national income of the country. Hence a careful watch is to be kept over the revenue implications of the international commercial agreements.

XVIII

LIQUOR EXCISE

§ 1. *INTRODUCTORY*

Another important source of State revenue is excise. By 'excise'[1] is ordinarily meant a tax or duty on commodities produced within the country, which consists in India of taxes on gasoline, alcoholic beverages, sugar, matches, cloth, tobacco etc. It also includes the revenue derived from a licence to conduct certain trades, such as those of tobacconists, brewers, distillers, etc.

Excise duties in India fall into two classes: (*i*) those that are levied for revenue, and (*ii*) those that are levied to restrict the consumption of commodities such as intoxicants and harmful drugs.

Taxes of the former class are, from the economic and fiscal point of view, the necessary corollary of import duties. Restrictive excises, though primarily meant to check consumption, bring in a large amount of revenue as well.

The principal excises falling in the first category are the duties on sugar, matches, cloth and tobacco. The revenue from restrictive excises includes the proceeds of duties on the sale and manufacture of 'country spirit' (spirit locally made in imitation of foreign liquor), hemp, drugs and opium.

Under the Constitution the State Governments are authorised to levy:

Duties of excise on the following goods manufactured or produced in the State and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India:

(*a*) alcoholic liquors for human consumption;

(*b*) opium, Indian hemp and other narcotic drugs and narcotics; but not including medicinal and toilet

[1] 'The word "excise" has no definite meaning in the terminology of taxation.' Lutz, H.L., *Public Finance*, Appleton, 1936, p. 567.

preparations containing alcohol or any substance included in sub-paragraph (*b*) of entry 51 of the seventh schedule.

Lessons from American Experience

In examining the principles of the liquor excise policy of a government, two views are commonly met with: those which advocate total prohibition, and secondly those which support modified prohibition so that the licensed vendor may not be replaced by illicit distillers and smugglers.

The answer to the question, Is prohibition possible? depends upon the question, What would be the cost? The prohibition problem should be studied primarily from the standpoint of administration, because the success or failure of prohibition depends upon the efficiency of administration.

A study of liquor-control administration in the United States during the period when the Eighteenth Amendment was in force has shown that the enforcement of prohibition is an impossibility.[1] Although the Eighteenth Amendment became law it was a dead letter.[2] The action taken by the Congress in controlling liquor consumption was quite inadequate. Vast amounts of illicit liquor were produced as a result of the prohibitive excises, and the consequent high prices gave bootleggers an excellent opportunity to make exceptionally high profits.

During the pre-prohibition period the illicit manufacture of liquor was secretly carried on. In the prohibition period 'the technique and the financial resources of big business enterprise were applied to the illicit production and sale of liquor.'[3] The evils of incomplete enforcement during the 'dry period' left legacies even after the repeal. 'The bootlegger is still with us,' observed Professor Studenski in *The National*

[1] The Eighteenth Amendment came into force from January 17, 1920. Under it the manufacture, sale, import, export or transportation in intoxicants was forbidden. 'Intoxicating liquors' were those which contained alcohol in excess of 0.5 per cent. The Repeal Amendment Proclamation was issued by the President on December 5, 1933.

[2] *See* Catlin, G.E.G., *Liquor Control*, Home University Library, pp. 135-46.

[3] The per capita consumption of alcohol has been greater under prohibition than during the war period, with high taxation and restricted production and sale. Warburton Clark, *The Economic Results of Prohibition*, Columbia University Press, 1932, p. 260.

Municipal Review.[1] Bootlegging has become so deep-rooted in American life that thousands find it a profitable occupation and are not prepared to give it up. Bootlegging has become a regular business. 'Repeal has materially diminished bootlegging, but has not eliminated it altogether.'[2]

The one conclusion which the American experience suggests is that 'prohibition is impossible by fiat except in communities where it has overwhelming popular support as a public policy. Excessive excises do not promote temperance but tempt the bootlegger, and thus the very object of prohibition is defeated.

The moral from the American experience is to discover methods which in theory may be less drastic than prohibition but give better results in practice. Perhaps the best way to achieve such results is to tax the liquor trade with moderation and to educate public opinion against liquor consumption. Such a policy, it would seem, is a compromise between the protagonists of prohibition and the believers in the doctrine of individual liberty who do not want any law for prohibition.

To achieve the most wholesome results both the methods should work side by side, for one without the other would not produce the desired results.

To promote temperance, moderation in taxation should be accompanied by: (*i*) limitation of hours during which intoxicating liquor can be sold; (*ii*) reduction in the number of shops; (*iii*) restrictions in quantity for sale both 'on licence' and 'off licence'; (*iv*) discriminating taxation on the stronger liquors; (*v*) curtailment of attractions ordinarily provided in liquor shops; and (*vi*) educating public opinion against liquor consumption.

The enlightenment of the masses, especially the backward classes (among whom the drink habit is very strong), through propaganda and education, is one of the most essential requisites for the promotion of temperance. Social legislation, however well-framed and prohibitive in character, would be

[1] Studenski, P., *Liquor Taxes and the Bootlegger*. Supplement to the *National Municipal Review*, Vol. XXIV, January, 1935, p. 63.
[2] Studenski, ibid., p. 66.

impotent as breaches of the law easily escape detection.[1] It is upon the bedrock of a sound public opinion that the success of a temperance movement rests. An attempt to force immediate restrictions would not banish the saloon but would result in diastrous consequences to public morality and the tax policy of the country. The experience of other countries suggests rather strongly that education and propaganda, working by conviction and persuasion, are perhaps no less effective than legislative compulsion in the attainment of prohibition.[2]

§2. *THE CONGRESS PROHIBITION PROGRAMME*

With the inauguration of Provincial autonomy the Congress Government in the Provinces had followed a policy of prohibition. The prohibition programme had created a new range of problems in Provincial finance in 1939-40. The Provincial Governments had introduced in the budgets for 1939-40, (*i*) employment tax; (*ii*) enhanced duty on petrol; (*iii*) sales tax and (*iv*) a provincial rate on urban areas to make up for the loss of revenue through excise. But as the period of the Congress Government's administration was a very short one, the policy of prohibition could not be implemented.

After independence a fresh impetus has been given to the policy of prohibition and a number of States have gone 'dry'. Meanwhile a special Committee was set up by the Planning Commission to survey the experiences gained by the States in implementing their prohibition policies. The Prohibition Enquiry Committee recommended integration of the schemes of prohibition with the development plans and suggested April, 1959 as the target for enforcing prohibition in the country on a uniform basis.

[1] The attempt to increase sobriety by means of a law which makes for more objectionable habits of drinking and destroys public morality, is obviously futile. Prohibition is no longer a child of yesterday. Its results can be perceived by all who have eyes to see. These results are such that the only possible conclusion is: the sooner we get rid of prohibition the better. *Report of the Official Prohibition Enquiry of 1923, Finland*, pp. 149-50. Quoted in the *Prohibition Experiment in Finland* by Joh. H. Wuorinen, Columbia University Press, 1931, p. 94.

[2] Wuorinen, *The Prohibition Experiment in Finland*, Columbia University Press, 1931, p. 237.

The Report of the Committee was considered by the Central and State Governments and broadly approved by the National Development Council in January, 1956. A resolution passed by the Lok Sabha on March 31, 1956, affirmed that prohibition should be regarded as an integral part of the second Plan and recommended the formulation of a programme to bring about nation-wide prohibition speedily and effectively.

The Planning Commission has commended the following steps to the States:

(*i*) Discontinuance of advertisements and other inducements for the sale of alcoholic drinks;

(*ii*) Stoppage of drinking in public premises (hotels, restaurants, clubs) and at public receptions. (In applying this rule, care should be taken to ensure that the rights of foreign missions are not effected and foreign visitors and tourists are not put to inconvenience or harassment.)

(*iii*) The setting up of technical committees to draw up phased programmes with the object of:

(*a*) reducing progressively the number of liquor shops both in rural and urban areas;
(*b*) gradually increasing the number of closed days during the week for liquor shops;
(*c*) reducing the supplies of liquor shops;
(*d*) progressively reducing the strength of liquor produced by distilleries in India;
(*e*) closing of shops in and near specified industrial and development-project areas;
(*f*) removal of shops to places away from the main streets and living quarters in towns and villages;

(*iv*) Taking of active steps to encourage and promote the production of cheap and health-giving soft drinks;

(*v*) Assistance to private agencies in the organization of recreation centres; and

(*vi*) Prohibition to be made a major item of constructive work in national extension and community-project areas and in rural welfare extension projects.

On the eve of the reorganization of States, there was total prohibition in Andhra, Bombay, Madras, Coorg, Kutch and

Saurashtra and partial prohibition (ranging from one dry district each in the Punjab and Madhya Bharat to nearly 70 per cent of the total area in Mysore) in Assam, Delhi, Madhya Pradesh, Orissa, Punjab, Uttar Pradesh, Madhya Bharat, Mysore, Travancore-Cochin and Himachal Pradesh.

In 1956, the States of Coorg and Kutch had adopted the policy of total prohibition before their merger. A phased programme of prohibition had also come into force in Rajasthan and the former States of Delhi, Bhopal, Hyderabad and Madhya Bharat. Among the important features of the phased programme were the prohibition of drinking in public as in Delhi, Bhopal and Rajasthan; reduction in the number of liquor shops as in Delhi and Madhya Bharat; an increase in the number of 'dry' days as in Delhi and Rajasthan and other measures like reduction in the period during which liquor can be sold and increase in the minimum age from 18 to 25 of the persons to whom it can be served. Steps to provide alternative recreation and to ban advertisement of liquor have also been taken in Delhi, while enforcement machinery has been improved in other States. Orissa enacted a comprehensive Prohibition Act in 1956.

In the following table are shown the area under prohibition and the population affected by it.

TABLE LXIII

AREA AND POPULATION UNDER PROHIBITION[1]

States and Territories	Total area (sq. miles)	Area under prohibition (sq. miles)	Percentage of Col. 3 to 2	Total population (in lakhs)	Population of 'dry' areas (in lakhs)	Percentage of Col. 6 to 5
Andhra Pradesh	1,05,700	56,693	53.6	312.6	199.0	63.6
Assam	85,062	3,860	4.5	90.4	15.0	16.6
Bombay	1,90,668	1,69,964	89.1	482.7	452.5	93.7
Kerala	14,937	8,615	57.6	135.5	70.2	67.9
Madhya Pradesh	1,71,300	30,119	17.6	260.7	55.2	21.2

[1] See *India*, 1958.

TABLE LXIII (*Continued*)

States and Territories	Total area (sq. miles)	Area under prohibition (sq. miles)	Percentage of Col. 3 to 2	Total population (in lakhs)	Population of 'dry' areas (in lakhs)	Percentage of Col. 6 to 5
Madras	50,174	50,174	100.0	299.7	299.7	100.0
Mysore	74,861	47,883	64.1	194.0	119.3	61.5
Orissa	60,250	25,631	42.5	146.5	82.8	56.5
Punjab	47,062	2,329	4.9	161.3	11.2	6.9
Rajasthan	1,32,098	34	—	159.7	0.1	—
Uttar Pradesh	1,13,423	19,350	17.6	632.1	135.3	21.4
Himachal Pradesh	10,922	1,648	15.1	11.1	2.0	18.0
Total	10,56,457	4,16,300	39.4	2,886.3	1,444.1	50.0

The area under prohibition is 39.4 per cent of the total area in which 50.0 per cent of the country's population lives.

Financial Results

The revenue from excise in some of the years as compared with 1938-39 is given in the following table.

TABLE LXIV

(In lakhs of rupees)

	1938-39	1948-49	1949-50	1950-51	1951-52	1952-53
Assam ..	35	95	88	93	81	76
Bihar ..	1,20	4,85	4,99	5,26	5,34	5,80
Bombay ..	2,90	6,17	4,09	1,07	85	1,07
Madhya Pradesh ..	64	2,19	2,24	2,31	2,23	2,23
Madras ..	3,72	3,67	59	55	39	34
Orissa ..	33	1,36	1,82	2,13	1,92	1,67
Punjab ..	1,02	2,38	2,32	2,08	2,39	2,16
U. P. ..	1,33	6,53	5,96	6,51	6,16	6,12
West Bengal ..	1,59	6,22	6,14	6,20	6,19	5,92
Total ..	13,09	34,32	29,03	27,04	26,28	26,07

Till 1950-51, nearly a third of the territories of India covered by the former princely States was outside the scope of the prohibition programme. The integration of the States into the Indian Union facilitated the extension of the prohibition programme to these areas as well. The following table brings out the speedy and effective manner in which prohibition is being extended. Between 1951-52 and 1955-56 the percentage of excise revenue to total revenue dropped from 11.6 to 5.8.

TABLE LXV

TOTAL AND EXCISE REVENUES (1951-52 to 1955-56)

(In crores of rupees)

Year			Total revenue	Excise revenue	Percentage of excise to total revenue
1951-52	..	..	428.18	51.45	11.6
1952-53	..	..	444.55	46.37	11.3
1953-54	..	..	484.20	44.55	8.3
1954-55(*a*)	..	..	511.13	42.98	7.8
1955-56(*a*)	..	..	684.50	42.55	5.8

(*a*) For 1954-55 and 1955-56, the contributions of the former States of Coorg, Kutch, Manipur and Tripura have been approximated to the figures for the year 1953-54.

The bulk of the excise revenue is derived from the poorer sections of society who spend as much as Rs. 3 on intoxicants for every rupee collected as tax. According to the estimate of the Prohibition Enquiry Committee, the per capita expenditure on the licit consumption of liquor in Madras during 1945-46 was Rs. 108 against the estimated per capita income in India of Rs. 265.

Conclusions

A policy of immediate total prohibition is the cherished ambition of many social reformers and politicians in India. Such a policy, however justifiable it may be from religious, social or other points of view, is not within the scope of practical finance. In the present financial condition, of the States,

when larger revenues are required to develop the nation-building departments, it is impracticable to sacrifice this source of revenue. The deficit so caused cannot be easily made up either by the substitution of another tax or group of taxes.

Secondly, prohibition, besides stopping the revenue, would require additional heavy expenditure for its enforcement.[1] Moreover, the more vigorous the policy for enforcement the more will the cost of prohibition increase. Finally, anything like real prohibition in India, where every palm tree, in addition to the *mahua* plant, is a ready source of alcohol, would require a standing army. Hence a policy of prohibition, on the score of expense and difficulty of enforcement, is not possible for India.

My own conclusion expressed with all diffidence is that India can hardly afford to go dry at the present stage of its economic development when it needs huge resources for its nation-building activities. Prohibition is perhaps a luxury to India. Besides, it will not improve the moral tone of the people for whom it is meant. It is perhaps a conscience-easing process for the protagonists of prohibition. Some States have already crippled their finances through a policy of prohibition. The sooner this policy comes to an end the better will it be for the country as a whole, as in a federal system of finance the revenues of the country are indivisible.

[1] The Indian Taxation Enquiry Committee put down 18 per cent of the tax revenue of the country as the probable cost of prohibition.

XIX

THE PLANS

§ 1. *INTRODUCTORY*

The Budget and the Plans

The Indian budgetary policy since 1952 has been profoundly influenced by planning. In Sections 2 and 3 we shall point out in some detail the objectives of the two Plans and their achievements. Broadly speaking, planning in India is concerned with a lay-out of limited resources to achieve specific economic and political ends; at the same time it is also used to further certain social aims, such as equality of incomes and better nutritions. This has resulted in an increase in the functions and scope of the budgetary policy. Two such changes stand out prominently. They are: (1) growth in the total volume of budget; (2) changes in the functions of budget. The budget of pre-war India was Rs. 84.47 crores; in 1951-52 it was Rs. 528.01 crores and in 1959-60 it was Rs. 757.51 crores. Thus the Plan and non-plan budget today is more than six times that of undivided India.[1] This increase in the budget has resulted in the imposition of a large number of taxes to finance the Plans. Besides, internal resources have been mobilized and external assistance has been sought to finance the total expenditure of Rs. 7,513 crores for the two Plans. The need for taxation has resulted in an additional tax burden. In fine it may be said that the revenue side of public finance has played an important role in the successful promotion of economic growth. The great increase in the amount of the expenditure in the public sector has facilitated the maintenance of a high level of activity. Without planning, the economy may have been faced with a larger volume of unemployment and depression as plagued the Indian economy in the 1930's. Thus with a new responsibility of the Government in the public sector, the budget is now an instrument of policy. An elaborate planning machinery

[1] *See* Chapter IX.

for the rational conduct of economic policy has slowly been built up during the past decade. However disappointing the results may have been in certain sectors of economic activities, even a carping critic cannot reasonably doubt that we would have been much worse off without planning. In the modern world of intense international economic competition, it is the business of the planners to refine their tools in general and the budget techniques in particular in order to promote the two fundamental aims of planning, viz. economic stability and economic growth.[1]

Planning for Growth

Any detailed account of the principles and techniques of planning would be outside the scope of this work. Nevertheless, a brief account of some of the heads of expenditure over which the Plan expenditure in underdeveloped countries can be incurred may be stated here. Broadly speaking the Plan expenditure in underdeveloped countries may contribute to the expansion of gross national production in two ways. Firstly it may provide the basic economic foundation in the form of overheads, without which existing resources cannot be fully exploited. Secondly it may increase economic productivity either by providing assistance for the establishment of new industries or by the introduction of better agricultural methods or by directly entering the field of production and trading. The former expenditure may again be classified under three broad categories: (*i*) expenditure on 'economic overheads' (*ii*) expenditure on 'social overheads' and (*iii*) provision on overheads which are on the borderline between the above two overheads. Expenditure on economic overheads provides the basic economic foundation without which limited resources cannot be put to their best possible use. Plan expenditure in India has been incurred on all the above overheads. In the field of economic overheads inadequate transport facilities have been one of the major obstacles in economic development. Mrs. Hicks has rightly

[1] The budget since 1921 was an account of the money for which the legislatures (to a limited extent) were responsible. The budget today performs two functions (*i*) accountability control to the House of the People and the State Assemblies; and (*ii*) as an instrument of policy.

observed that 'in most under-developed countries inadequate transport systems, both road and rail, are serious obstacles in the path of growth; a further trouble very commonly encountered is the inadequacy of port facilities which lead to delay in clearing both exports and imports. These bottlenecks not only tend to reduce overseas income, but also make it more difficult to preserve internal price stability.'[1]

In all underdeveloped countries the main difficulty in planning is to establish objective priorities of expenditure. A rough and ready allocation of resources is drawn after a careful consideration of the existing economic conditions in each country. In India, though great weight in the Plan expenditure has been given to economic overheads, it was necessary to spend quite a large portion of the expenditure over the social overheads because without such an expenditure in advance full advantage cannot be taken of industrial and agricultural improvements as they occur. Hence in both the Plans, expenditure on social overheads especially towards education, public health and community development, forms an important feature of the Plans.

There are, however, some advantages and limitations of expenditure on social overheads. Such expenditure may imply greater local willingness to foot a part of the bill, (e.g. in the case of community projects), thus resulting in tapping additional sources of revenue in cash/ kind (voluntary labour) which otherwise would not be forthcoming. Social overheads also need much less capital grants than economic overheads. But the real danger in such expenditure lies in the control and allocation of priorities which will increase gross national production. Experience points out that often expenditure on social overheads may be diverted because of powerful local vested interests in rich areas rather than in depressed localities which really need greater attention. It has been found that 'it is all too easy for rich and developed countries to overtap the bounds of economic wisdom in the social services, sacrificing the benefit of the many to favour the few; for under-

[1] Hicks, Mrs. Ursula, *Public Finance* (1955) pp. 295-6. For some of the account in this Section I am obliged to Mrs. Hicks.

developed countries the danger is still great.'[1] Hence in Indian planning control over such expenditure should be very strict and great care should be taken in the distribution of social overheads among the different States and the regions of the same State.

Again, it must be remembered that expenditure on social overheads is rather negligible in increasing the growth of national production in the short run because the real benefit of such expenditure can only be realized in the long run. Mrs. Hicks has rightly observed: 'the provision of social overheads indeed in the short run not uncommonly creates more difficulties than it solves, for instance by hastening the break-up of an existing social structure before the new economic structure is ready to absorb the labour set free. This strengthens the argument for watchfulness and caution, the cost in terms of alternative use of resources needs to be constantly weighed.[2]

In addition to expenditure on economic and social overheads, provision has been made in both the Plans for expenditure on borderline overheads e.g. electric power, flood control, drainage, irrigation, river-valley projects and soil erosion. Such expenditure is also on services for economic development; but here again the full benefit from such expenditures can only be realized in a long period. Such works provide basic conditions for improving productivity in industry and agriculture and should not be neglected even though their addition to the national output takes a fairly long time.

In India irrigation works are divided into two broad categories; major works and minor works. Minor works will raise productivity much more quickly in a short time but in the long run less effectively. Major works will take a long time to be productive but once they are productive their efficiency would be much more than that of minor works. Hence a word of caution is necessary. 'If the small projects are pro-

[1] Mrs. Hicks, op. cit., p. 297.

[2] Ibid. In view of the above criticism of expenditure on social overheads, it is necessary to exercise a high degree of control on expenditure on the Community Programme in India.

ceeded with haphazard, however, funds are apt to be frittered away without securing the best use of resources.'[1]

Broadly speaking the basic problems in planning in India are: (*i*) the allocation of resources on economic, social and 'borderline' overheads; (*ii*) the extent to which the State should take direct responsibility for the economic development of the country in preference to giving aid and support to the private sector.

There are some special problems which need consideration at this stage. There may be some industries which need development but whose costs are too high and need a subsidy. Subsidies, however, detract rather than add to gross national production. The development of such industries falls within the category of expenses on social overheads as they are a charge on revenue. However, if the potential market for such industries is wide and they need technical 'know-how', then the State should participate in their operation by offering technical advice and capital.

Finally, public expenditure in Indian planning has been incurred for a variety of purposes, e.g. provision of capital for establishing of industries and raising agricultural productivity. Under this head we may include the supply of capital by Industrial Finance Corporations (Central and States) in large quantities; provision of information and services, (e.g. Small-Scale Service Institutes); suitable sites in industrial estates; legal assistance in land acquisition for starting large-scale farming. Such expenditure is not heavy and most of it is recouped from the beneficiaries in a short/long period.

§2. *THE FIRST FIVE-YEAR PLAN, 1951-56*

Objectives

The central objective of planning in India is to initiate a 'process of development which will raise living standards and open out to the people new opportunities for a richer and more varied life.' Economic planning is viewed as an integral part of a wider process aimed not merely at the deve-

[1] Hicks, op. cit., p. 298.

lopment of resources in a narrow technical sense, but at the development of human faculties and the building up of an institutional framework adequate to the needs and aspirations of the people.

The First Five Year Plan[1] was conceived as the first in a series of such plans directed at substantially raising the economic and social standards of the Indian people. The long-term objective is to double the per capita income and to increase consumption standards by a little over 70 per cent by 1977. During the First Plan period (1951-56) the national income rose from about Rs. 9,000 crores to about Rs. 10,000 crores, an increase of about 11 per cent. Since economic progress required a large amount of capital accumulation, it was visualized that the rate of saving as a proportion of the national income would have to increase from 5 per cent in 1950-51 to 6¾ per cent in 1955-56; 11 per cent in 1960-61 and 20 per cent in 1967-68.

Plan Outlay[2]

The aggregate outlay on the Plan over the five years was about Rs. 2,012.4 crores. The distribution of the Plan outlay between the Centre and the States is shown in the table below:

	Plan target Original	Plan target Revised
Central	1233.7	1389.5
States	835.0	988.2
Total	2068.7	2377.7

The Plan as formulated in 1952 proposed a total outlay of Rs. 2,069 crores by the Central and State Governments together. Later, the Plan was expanded and various adjustments were made mainly with a view to stepping up the aggregate outlay from the levels in the early years to the

[1] The account given in this chapter is based on: (*i*) *The First Five-Year Plan*; (*ii*) *The Second Five-Year Plan*; (*iii*) *Review of the First Five-Year Plan* (1957).

[2] The figures given here are based on the *Review of the Five-Year Plan*.

progress made in the later years and to provide more opportunities for employment. These adjustments increased the extent of the Plan to Rs. 2,378 crores. As the preceding table shows, the target of expenditure to be incurred by the Centre was Rs. 1,390 crores. As compared to these revised targets, the expenditure by the Centre is estimated to have been about Rs. 1,115 crores and the expenditure by the States about Rs. 897 crores. The expenditure in the early years of the Plan was rather slow but there was a substantial increase in the fourth and fifth years; as much as 57 per cent of the total expenditure over the five-year period being accounted for in these two years.

Another important feature in the expenditure of the outlay was the short-fall in some of the main heads of expenditure. In general, these short-falls occurred either because of the late commencement of the schemes or because of inadequate administrative and organisation arrangements for implementation.

The following table compares the pattern of outlay as it actually materialised over the Plan period with the pattern that was in view when the Plan was initially formulated.

	Per cent of the total outlay as later estimated	Per cent of the total outlay as originally proposed
1. Agriculture and Community Development	15.0	16.0
2. Irrigation and Power	29.0	28.0
3. Industries	5.0	8.0
4. Transport and Communications ..	26.0	24.0
5. Social Services (including miscellaneous)	25.0	24.0
Total ..	100.0	100.0

It will appear from the above table that apart from the outlay on industries, where a large short-fall occurred, the rest of the pattern conforms fairly closely to the initial order of priorities accepted in the Plan. As much as 43 per cent

of the Plan outlay was devoted to agriculture and irrigation and power, which had received the first priorities in the Plan. Transport and communications absorbed 26 per cent of the Plan expenditure; and social services, including the rehabilitation of displaced persons and some miscellaneous items, also accounted for another 26 per cent.

The distribution of the aggregate Plan outlay in the field of investment and current expenditure on capital account corresponding to the total outlay of Rs. 2,012 crores amounted to Rs. 1,470 crores; the balance, Rs. 542 crores, was expenditure on revenue account. Part of this latter has been of the nature of investment, so that on the whole, if aggregate expenditure on the Plan is taken at Rs. 1,960 crores, the total of investment in the public sector works out at around Rs. 1,500 crores. This, as together with the estimated investment of about Rs. 1,600 crores in the private sector works out to a total of about Rs. 3,100 crores aggregate investment in the economy.

Financing of the Plan

The picture of financial resources for the Plan—Centre and States combined—is shown in the table below:

FINANCING OF THE PLAN, 1951-56

(In crores of rupees)

	Total	*Plan 1951-56* Original	Revised
1. Outlay on the Plan	2012.4	2069.0	2377.7
2. Budgetary resources ..	1277.3	1258.0	—
3. External assistance	203.2	521.0	—
4. Deficit	531.9	290.0	—

In the Plan, as it was originally formulated, the estimate of total domestic resources to be raised by way of taxes, loans, small savings etc. was Rs. 1,258 crores, the balance of Rs. 811 crores being financed from external assistance to the extent available and from a combination of measures to raise domestic resources by way of taxes or deficit finance as the circums-

tances might warrant. External assistance to the tune of Rs. 156 crores was already in sight when the Plan was formulated and it was expected that some further assistance would also be available. At the same time it was recognized that deficit financing should not, unless special circumstances arose, exceed Rs. 290 crores which corresponded to the withdrawal of sterling balances. Actually, as the above table shows, budgetary resources came close to expectations; external assistance utilised amounted to about Rs. 200 crores, which is only about Rs. 50 crores more than the assistance in sight when the Plan was formulated. Consequently, the extent of deficit financing necessary had to exceed the limit of Rs. 290 crores indicated in the Plan.

Coming to a more detailed account of financing the Plan by the Centre and States. Out of the outlay of Rs. 1,115 crores at the Centre over the five-year period, Rs. 420 crores (about 38 per cent of the total) was financed from revenue surpluses and the earnings of railways; Rs. 358 crores (some 32 per cent) became available by way of net receipts from loans, small savings and other capital receipts. As against this total of Rs. 778 crores, the Centre transferred Rs. 350 crores to the States by way of Central assistance for State Plans. The balance of Rs. 428 crores remaining with the Centre was augmented by the receipt of Rs. 203 crores of funds from abroad. Thus the Centre had at its disposal a sum of Rs. 631 crores against its Plan outlay of Rs. 1,115 crores. On this basis, deficit financing at the Centre for the five-year period works out at Rs. 484 crores. The total deficit for the five-year period at the Centre was Rs. 428 crores.

In the States the total outlay of Rs. 897 crores was financed as follows:

	(In crores of rupees)
(*i*) Current revenues	269
(*ii*) Public borrowing and capital receipts ..	230
(*iii*) Central assistance	350
(*iv*) Deficit financing	48
Total ..	897

The States provided from their revenues about 30 per cent of the resources required for financing their Plans. Another 26 per cent or so was raised by way of borrowing and other capital receipts and as much as 39 per cent represents the contribution of the Centre. Taking the Plan period as a whole there was the extent of 43 crores deficit financing by the States taken together.

Current Revenues

We now examine in a more detailed manner the above resources for financing the Plan. In the Plan as initially formulated the contribution of current revenues including fresh taxation and the receipts of railways was estimated at Rs. 740 crores. Thus, the surpluses of public authorities were assumed to contribute 58 per cent of the total budgetary resources amounting to Rs. 1,258 crores. While, the aggregate budgetary resources were, more or less, of the order initially expected, the contribution of current revenues and the earnings of the railways over the Plan period worked out at Rs. 690 crores as compared to the target of Rs. 740 crores. The short-fall is accounted for by lower contribution from the railways; the balance from revenues taking the Centre and the States together being up to expectation. The Centre was able to find from current revenues Rs. 145 crores more than the Plan targets required while in the States there was almost an equal short-fall. This short-fall in the States occurred in spite of the transfer of Rs. 80 crores to them under the Finance Commission's award.

It was recognized from the very beginning that the aim of fiscal policy both at the Centre and in the States should be to provide as large an amount as possible out of the current revenues to finance the rising investment expenditure undertaken in the course of the Plan period. The Central Government imposed substantial taxation in 1951-52 partly for this reason but mainly in order to generate a disinflationary climate. Export duties which had been raised in 1950-51 were increased further on a number of commodities in order to draw a proportion of the increasing incomes being made in the export sector into the public exchequer. The other

measures taken in that year included a surcharge on income-tax, an increase in the corporation tax, additional excise duties and import duties. Altogether, the increase in taxation proposed in that year amounted to Rs. 32 crores. During 1951-52 and 1952-53 inflationary pressures had abated and some further reductions had to be made in export duties. The other changes made in these two years were relatively small. In 1954-55, sizeable increases were made again in excise duties. By this time, the expenditure on the Plan had risen substantially and the outlay was stepped up as rapidly as possible in order to ensure the fulfilment of the Plan. The additional taxation imposed in 1954-55 amounted to Rs. 11 crores. In 1955-56, the final year of the Plan, both direct and indirect taxation was raised further, the major increase being under income-tax and excise duties. The yield of the new tax measures was about Rs. 17 crores for the year. Altogether, over the five years the yield of additional measures of taxation at the Centre, excluding export duties, which in their nature are variable, was about Rs. 175 crores.

The contribution of the railways from their current revenues to the financing of their development programmes totalled Rs. 115 crores over the Plan period as compared to Rs. 170 crores for which credit was taken in the estimates initially presented in the Plan document. The railway fares were put up in 1951-52, the estimated yield of the increase being Rs. 18 crores for the year. Some adjustments were also made in freights which were again somewhat changed in 1955-56. Over the five-year period, the increases in fares and freights yielded about Rs. 100 crores. Nevertheless, the contribution of the railways was not up to the initial expectations because of the increase in working expenses and a fall in earnings as a consequence of the emergence of recessionary conditions in 1952-53 and 1953-54.

As regards the States, the contribution from revenues over the five-year period was Rs. 269 crores as compared to the Plan estimate of Rs. 410 crores—a short-fall of about 34 per cent—despite, as mentioned earlier, the transfer of Rs. 80 crores to them as a result of the Finance Commission's award. The target of additional taxation by States as laid down in

the Plan was Rs. 230 crores. Actually, it is estimated that the total yield of all the measures taken by State Governments during the Plan period was Rs. 80 crores. The progress in the matter of additional taxation in the States was not commensurate with the requirements of the Plan.

Of the total yield of Rs. 80 crores, about half was accounted for by general sales tax, tax on sale of motor spirit and sales tax on tobacco, cigarettes and cigars. Taxes on motor vehicles also made a significant contribution. While irrigation rates were put up in some States, these increases yielded only Rs. 6 crores as compared to the Plan estimate of Rs. 29.5 crores. The additional revenue from taxation of land which the Plan had placed at Rs. 34 crores turned out to be only Rs. 5.4 crores. It must also be mentioned that while the Plan had estimated the States' share of Estate Duty at Rs. 21 crores, these sources actually contributed a little over Rs. 2 crores.

Public Borrowings

At the time the Plan was formulated, the outlook for public borrowing was far from encouraging, the market in fact being so weak that there was pressure on the Reserve Bank to support it. Consequently, the targets for borrowing by the Centre and by the States were kept at low levels, viz. Rs. 36 crores for the Centre and Rs. 79 crores for the States. Taking the Centre and the States together the net loans from the market in 1951-52 was negative to the extent of Rs. 22.8 crores. In other words, Rs. 22.8 crores was paid out by way of repayment of maturing loans. In the next two years the market showed some improvement, but it was not until the fourth year that substantial borrowing programmes could be undertaken. The Centre continued to make repayments for the first three years, Rs. 34.2 crores in 1951-52, Rs. 0.9 crores in 1952-53 and Rs. 37.2 crores in 1953-54. The States were able to put through moderate borrowing programmes in the first two years and were able to step them up substantially in 1953-54. In the first three years of the Plan, taking the Centre and the States together, repayments of maturing loans exceeded the contribution of fresh loans by Rs. 5 crores.

In 1954-55 the Centre raised a combined loan of Rs. 195 crores of which Rs. 46 crores represented maturities, the net borrowings thus being Rs. 113 crores. Of this, Rs. 26 crores was made available to the States. In addition, two States were able to borrow Rs. 7 crores directly. In 1955-56 the combined net loan receipts of the Centre and the States amounted to Rs. 89.4 crores. Over the five years, the Plan target for market loans was exceeded by Rs. 89 crores.

Small Savings

The following table shows the collections of small savings annually for the Plan period.

Year	(In crores of rupees)
1951-52	38.5
1952-53	40.2
1953-54	37.8
1954-55	54.6
1955-56	66.1
Total ..	237.2

The record of small savings showed steady improvement over the Plan period, the total collection being Rs. 237 crores as compared to the target of Rs. 225 crores. The collections from small savings by the end of the Plan period were about double the collections in 1950-51, and it is significant that over the Plan period they have financed about 12 per cent of the Plan outlay. In addition to these small savings, provident fund contributions and other similar items of unfunded debt at the Centre contributed Rs. 67 crores over the five-year period.

External Assistance

External assistance (in loans and grants) made available over the Plan period for development programmes in the public sector aggregated to Rs. 296 crores. Of this about Rs. 188 crores was utilised over the five years, leaving a carry-forward of Rs. 108 crores for the next Plan period. The following table shows the amounts authorised from

various sources and utilised during the Plan period year by year:

AUTHORISATION AND UTILISATION OF EXTERNAL ASSISTANCE (Public Sector) 1951-52 to 1955-56

Loans	Total authorisations (1951-56)	Total utilisation (1951-56)
U. S. Government Wheat Loan ..	90.3	90.3
Indo-U. S. Aid Programme	39.3	4.5
International Bank	12.5	7.6
Total ..	142.1	102.4
Grants:		
Indo-U. S. Aid Programme	102.5	58.2
Colombo Plan:		
Canada	32.34	19.7
Australia	11.08	5.1
New Zealand	1.7	0.3
U. K.	0.4	0.04
Ford Foundation	5.6	2.1
Indo-Norwegian Programme	0.66	0.27
Total Grants ..	154.28	85.71
Total Grants and Loans	296.38	188.11

Of the three loans extended by the International Bank to the public sector before the First Plan period, the Railway loan was entirely used up before the commencement of the Plan. In regard to the other two loans—the Agricultural Machinery Project loan and the Bokaro-Konar Loan (D.V.C.) an amount of Rs. 4.8 crores was utilised before the Plan period and an unutilised balance of Rs. 7.5 crores carried over into the Plan period. The International Bank advanced a second loan of Rs. 5 crores for the Damodar Valley Corporation in January, 1953. The Agricultural Machinery Project loan was completely utilised by the end of 1953-54; and most of the Bokaro-Konar loan by the end of 1955-56. Of the Second

D.V.C. loan only a little over Rs. 1 crore was utilised by the end of the Plan period.

Apart from the loans to the public sector, the International Bank advanced three loans to the private sector during the First Plan period. The first of these was a loan for Rs. 15 crores extended to the Indian Iron and Steel Co. in December, 1952. The second was a loan of Rs. 7.7 crores for the Trombay Project (November, 1954), and the third a loan of Rs. 4.8 crores for the Industrial Credit and Investment Corporation of India (March, 1955).

Deficit Financing

We may now sum up the budgetary position, *vis-à-vis* the plan in terms of the budgetary deficits which were incurred year by year over the Plan period. Table LXVI shows the position.

In 1951-52 there was a large revenue surplus at the Centre as a result of the measures taken to take a share of the extra-ordinary earnings arising from the Korean war boom. This resulted in a surplus of Rs. 55 crores in the Central Budget as a whole in spite of a capital account deficit of Rs. 73 crores. The States had in that year a revenue surplus of Rs. 12 crores but an overall deficit of Rs. 45.6 crores. For the Centre and the States together the year closed with an overall surplus of Rs. 10 crores. Thereafter the overall position for the Centre and the States combined had been one of deficit year after year. In 1952-53 the deficit at the Centre was Rs. 30.9 crores and the States Rs. 50 crores giving a total of Rs. 80.9 crores. The Centre's revenue surplus fell as low as Rs. 8.5 crores in 1953-54 and the States had actually a deficit of Rs. 2.9 crores on revenue account. On capital account the Centre's deficit widened to Rs. 135.7 crores, while the States had a surplus of Rs. 52.6 crores. The aggregate budgetary deficit, taking the Centre and the States together, thus turned out to be about the same as in the previous year. The surplus on capital account in the States in 1953-54 as well as in the following year is connected mainly with the State trading transactions—i.e. the destocking of foodgrains and some repayment of the loans and advances made earlier. The

Table LXVI

BUDGETARY SURPLUS OR DEFICIT OF THE CENTRE AND STATES

(In crores of rupees)

	1950-51	1951-52	1952-53	1953-54	1954-55	1955-56 Revised Estimates	Total Plan period (1951-56)
			(Accounts)				
I. Centre							
1. Surplus(+) or deficit(—) on revenue account	(+) 59.2	(+)128.2	(+) 38.9	(+) 8.5	(+) 33.5	(+) 10.3	(+)219.4
2. Surplus(+) or deficit(—) on capital account	(—) 14.7	(—) 72.9	(—) 69.8	(—)135.7	(—)178.9	(—)245.9	(—)703.2
3. Overall surplus(+) or deficit(—) of the Centre	(+) 44.5	(+) 55.3	(—) 30.9	(—)127.2	(—)145.4	(—)235.6	(—)483.8
II. States (A, B & C)							
1. Surplus(+) or deficit(—) on revenue account	(+) 3.7	(+) 12.1	(+) 3.4	(—) 2.9	(—) 10.7	(—) 66.3	(—) 64.4
2. Surplus(+) or deficit(—) on capital account	(+) 10.0	(—) 57.7	(—) 53.4	(+) 52.6	(+) 63.5	(+) 9.3	(+) 14.3
3. Overall surplus(+) or deficit(—) in the States	(+) 13.7	(—) 45.6	(—) 50.0	(+) 49.7	(+) 52.8	(—) 57.0	(—) 50.1
III. Overall surplus(+) or deficit(—) of the Centre and States	(+) 58.2	(+) 9.7	(—) 80.9	(—) 77.5	(—) 92.6	(—)292.6	(—)533.9

measures of additional taxation taken at the Centre in 1954-55 again raised the surplus at the Centre for that year to Rs. 33.5 crores. The capital account deficit rose further to Rs. 178.9 crores and the overall deficit in the Central budget to Rs. 145.5 crores. In the States the revenue deficit of Rs. 10.7 crores was more than made up by the capital account surplus of Rs. 63.5 crores. The overall budgetary deficit for the Centre and States together worked out at Rs. 92.6 crores.

Thus, for the first four years, deficit financing amounted to Rs. 241 crores. For the final year of the plan revised estimates indicate a deficit of Rs. 292.6 crores overall. For the five-year period, the total amount of deficit financing is thus placed at Rs. 240 crores. As compared to the estimated plan outlay of Rs. 1,960 crores deficit financing works out at 21 per cent of the total. It will be noticed that over 60 per cent of the deficit financing in the Plan period is accounted for by the last two years of the Plan.[1]

Mobilisation of Resources: An Assessment

In the preceding pages we have reviewed the contribution of each major source financing the Plan. It is necessary now to piece together the picture as a whole and to attempt an overall appraisal.

Briefly, the Plan outlay of Rs. 1,960 crores was financed as follows:

	(In crores of rupees)	Percentage of total
(*a*) Taxation and the surpluses of railways	752	38
(*b*) Market borrowings	205	10
(*c*) Small savings & unfunded debt ..	304	16
(*d*) Other capital receipts	91	5
(*e*) External assistance	188	10
(*f*) Deficit financing	420	21
	1,960	100

[1] See *Review of the First Five Year Plan*, May, 1957, p. 34.

The pattern of financing indicated by the above table can by itself be considered reasonably satisfactory. But the major problems for a developing economy is to get a larger proportion of national income into the public exchequer. By the end of the Plan period, no more than a small beginning can be said to have been made in this direction. The following table shows public revenues as percentage of National Income.[1]

TABLE LXVII

	1950-51	1951-52	1952-53	1953-54	1954-55	1955-56
1. Total revenue receipt as percentage of national income ..	8.1	9.1	8.4	8.0	9.4	10.0
2. Tax revenue as percentage of national income ..	6.6	7.5	6.9	6.4	7.5	7.9
3. Non-tax revenue as percentage of national income ..	1.5	1.6	1.6	1.6	1.9	2.1

From the above table it will appear that revenue receipts as a percentage of national income increased from 8.1 per cent in 1950-51 to 10 per cent in 1955-56 and tax revenue as such went up from 6.6 per cent of the national income in 1950-51 to about 7.9 per cent in 1955-56. Only by a progressive enlargement of the public revenues with suitable structural changes in the tax system and a reorientation of borrowing techniques can developmental programmes involving outlays much larger than in the First Plan period be seen through without creating financial and economic instability.

We have now reviewed the important features of the First Five Year Plan. In the next Section the highlights of the Second Plan are described. An attempt will be made in Section IV to give an account of the achievements of the two Plans.

[1] See *Review of the First Five Year Plan*, 1957.

§3. *THE SECOND FIVE YEAR PLAN (1956-61)*

Objectives

Having described the main features of the First Five Year Plan, we now pass on to give an account of the Second Five Year Plan.

The Second Five Year Plan covers the period from April 1956 to March 1961. The main objectives of the Plan are: (*i*) an increase of 25 per cent in the national income; (*ii*) rapid industrialisation with particular emphasis on the development of basic and heavy industries; (*iii*) a large expansion of employment opportunities; and (*iv*) a reduction of inequalities in income and wealth and a more even distribution of economic power.

Outlay and Allocations

The original development outlay of the Central and State Governments amounted to Rs. 4,800 crores over the period of the Second Plan, as compared with the target of Rs. 2,356 crores and the actual outlay of Rs. 1,960 crores under the First Plan.[1] This did not include the contributions in cash or kind made by the people towards the execution of local development works.

A comparative view of the distribution of outlay by major heads of development under the First and Second Plans is indicated in Table LXVIII.

It will appear from the above table that the percentage of expenditure on agriculture and community development, irrigation and power, industry and mining, transport and communication, and social services is 11.8; 19.0; 18.5; 28.9; 19.7 per cent respectively. The percentage increase in expenditure during the Second Plan over the First Plan is as follows:

	Per cent increase
1. Agriculture & Community Development ..	59.1
2. Irrigation & Power	38.1
3. Industry & Mining	397.2
4. Transport & Communication	148.7
5. Miscellaneous	43.5

[1] This outlay has subsequently been revised by the National Development Council to Rs. 4,500 crores.

DISTRIBUTION OF PLAN OUTLAY BY MAJOR HEADS OF DEVELOPMENT

TABLE LXVIII

	First Five Year Plan		Second Five Year Plan		Percentage increase of (3) over (1)
	Total provision (Rs., crores)	Per cent	Total provision (Rs., crores)	Per cent	
	1	2	3	4	5
Agriculture and Community Development ..	357	15.1	568	11.8	59.1
(a) Agriculture ..	241	10.2	341	7.1	
Agricultural programmes	197	8.3	170	3.5	
Animal Husbandry ..	22	1.0	56	1.1	
Forests ..	10	0.4	47	1.0	
Fisheries ..	4	0.2	12	0.3	
Co-operation ..	7	0.3	47	1.0	
Miscellaneous ..	1	..	9	0.2	
(b) National Extension and Community Projects ..	90	3.8	200	4.1	
(c) Other Programmes ..	26	1.1	27	0.6	
Village Panchayats ..	11	0.5	12	0.3	
Local Development Works	15	0.6	15	0.3	
Irrigation & Power ..	661	28.1	913	19.0	38.1
Irrigation ..	384	16.3	381	7.9	
Power ..	260	11.1	427	8.9	
Flood control and other projects, investigation etc. ..	17	0.7	105	2.2	
Industry and Mining ..	179	7.6	890	18.5	397.2
Large and Medium Industries	148	6.3	617	12.9	
Mineral development ..	1	..	73	1.5	
Village and Small Industries ..	30	1.3	200	4.1	

TABLE LXVIII (*Continued*)

	First Five Year Plan		Second Five Year Plan		Percentage increase of (3) over (1)
	Total provision (Rs., crores)	Per cent	Total provision (Rs., crores)	Per cent	
	1	2	3	4	5
Transport and Communications ..	557	23.6	1,385	28.9	148.7
Railways	268	11.4	900	18.8	
Roads	130	5.5	246	5.1	
Road Transport	12	0.5	17	0.4	
Port and Harbours ..	34	1.4	45	0.9	
Shipping	26	1.1	48	1.0	
Inland Water Transport ..	—	—	3	0.1	
Civil Air Transport ..	24	1.0	43	0.9	
Other Transport ..	3	0.1	7	0.1	
Posts and Telegraphs ..	50	2.2	63	1.3	
Other communications ..	5	0.2	4	0.1	
Broadcasting	5	0.2	9	0.2	
Social Services	533	22.6	945	19.7	77.3
Education	164	7.0	307	6.4	
Health	140	5.9	274	5.7	
Housing	49	2.1	120	2.5	
Welfare of Backward Classes ..	32	1.3	91	1.9	
Social Welfare	5	0.2	29	0.6	
Labour and Labour Welfare ..	7	0.3	29	0.6	
Rehabilitation	136	5.8	90	1.9	
Special scheme relating to educated unemployment ..	—	—	5	0.1	

Distribution of Plan Outlay

Of the total outlay of Rs. 4,800 crores, Rs. 2,559 crores represents expenditure to be incurred by the Centre and Rs. 2,240 crores by the State Governments. The distribution of the outlay under major heads of development for the Centre and the States is shown separately in the following table:

TABLE LXIX

(In crores of rupees)

	Centre	States	Total	Investment outlay	Current outlay
Agriculture and Community Development	65	502	568[1]	338	230
Irrigation and Power ..	105	808	913	863	50
Industry and Mining ..	747	143	890	790	100
Transport and Communications	1,203	182	1,385	1,335	50
Social Services	396	549	945	455	490
Miscellaneous	43	56	99	19	80
Total ..	2,559	2,240	4,800	3,800	1,000

[1] Includes the unallocated portion of Rs. 1 crore for NES and Community Projects in the States.

Of the total outlay, roughly Rs. 3,800 crores represent investment, that is, expenditure on the building up of productive assets, and Rs. 1,000 crores on what may broadly be called current developmental expenditure.

The likely level of private investment over the Second Plan period is placed at Rs. 2,400 crores which is distributed as follows:

TABLE LXX

PRIVATE INVESTMENT (Second Plan)

(In crores of rupees)

Organised industry and mining	575
Plantations, electricity undertakings and transport other than the railways	125
Construction	1,000
Agriculture, and village and small-scale industries ..	300
Stocks	400

In the First Plan total investment in the economy was estimated roughly at about Rs. 3,100 crores, the ratio of public to private investment being 50 : 50. In the Second Plan, the combined target of investment in the two sectors is Rs. 6,200 crores, the ratio of public to private investment being 61 : 39.

Changes in Economic Structure

The expected increase in national income, investment, domestic savings and consumption expenditure, at the end of the Second Plan period as compared to the position in 1950-51 and in 1955-56 is indicated below:

TABLE LXXI

NATIONAL INCOME, INVESTMENT, SAVINGS AND CONSUMPTION

(In crores of rupees at 1952-53 prices)

	1950-51	1955-56	1960-61	Percentage increase during 1951-56	Percentage increase during 1956-61
Net National Product by Industrial Origin					
Agriculture and Allied Pursuits ..	4,450	5,230	6,170	18	18
Mining	80	95	150	19	58
Factory Establishments ..	590	840	1,380	43	64
Small Enterprises	740	840	1,085	14	30
Construction	180	220	295	22	34
Commerce, Transport and Communications	1,650	1,875	2,300	14	23
Professions and Services including Government Administration ..	1,420	1,700	2,100	20	23
Total National Product (National Income) ..	9,110	10,800	13,480	18	25
Per Capita Income (rupees) ..	253	281	331	11	18
Investment, Savings and Consumption					
Net Investment ..	448	790	1,440	—	—
Net Inflow of Foreign Resources	7	34	130	—	—
Net Domestic Savings ..	455	756	1,310	—	—
Consumption Expenditure (National Income less Net Domestic Savings) ..	8,655	10,044	12,170	—	—
Investment as percentage of National Income ..	4.94	7.31	10.68	—	—
Domestic Savings as percentage of National Income ..	4.98	7.00	9.7	—	—

From the preceding table it will appear that the national income is expected to increase from Rs. 10,800 crores (1955-56) to Rs. 13,480 crores in (1960-61), amounting to an increase of 7 per cent. Net investment will increase from Rs. 790 crores to Rs. 1,440 crores. Investment as a percentage of national income will increase from 7.31 per cent to 10.68 per cent. The growth of domestic savings as a percentage of national income will increase only by 2.7 per cent.[1]

Financial Resources

Table No. LXXII indicates how the Second Plan was to be financed.

TABLE LXXII

ESTIMATES OF RESOURCES (Second Plan)

(In crores of rupees)

Surplus from current revenues		800
(a) At 1955-56 rates of taxation	350	
(b) Additional taxation	450	
Borrowings from the public		1,200
(a) Market loans	700	
(b) Small savings	500	
Other budgetary sources		400
(a) Railways' contribution to the development programme	150	
(b) Provident funds and other deposit heads ..	250	
Resources to be raised externally		800
Deficit financing		1,200
Gap to be covered by additional measures to raise domestic resources		400
		4,800

The original outlay of the Plan was put at Rs. 4,800 crores. This amount was to be raised from any surplus from current revenues (Rs. 800 crores); additional taxation (Rs. 1200 crores); borrowings from the public, (Rs. 400 crores); contributions from railways, (Rs. 150 crores); external loans (Rs.

[1] We examine these tendencies in the later portion of the chapter.

800 crores); deficit financing (Rs. 1200 crores). In spite of the above estimates a gap of Rs. 400 crores was left uncovered which it was thought could be covered by additional measures to raise domestic resources.

The estimate of Rs. 700 crores of loans from the public assumed that the annual receipts from this source will, on an average, be considerably higher than they had been during the First Plan. The nationalisation of the life insurance was expected to prove a growing source of public borrowings. In the case of small savings also, the target of Rs. 100 crores a year on an average required a further substantial stepping up of these collections, as compared with the net receipts in 1955-58 (Rs. 65 crores).

The railways were expected to contribute Rs. 150 crores to their Rs. 900 crores programme, both through selective adjustments in rates and freights and an increase in traffic. In addition, the railways were to make, in the Plan period, a contribution of Rs. 225 crores for current depreciation, which was not included in the Plan.

The Plan also took credit for Rs. 800 crores of external resources, which was about four times the amount utilised from foreign loans and grants during the First Plan period. In the First Plan period, external finance amounting to Rs. 298 crores was made available for development programmes in the public sector, of which Rs. 200 crores was utilised. The balance of about Rs. 100 crores was thus available for utilisation in the Second Plan period. In addition, arrangements were made for credit from the U.S.S.R.[1] and U.K. Governments and British bankers for a net amount of Rs. 76 crores to finance the steel projects.

Plan Financial Reappraisal—November 1958[2]

The Plan had hardly worked for three years when the necessity was felt to revise the Plan financial outlay. The position regarding the Plan outlay and financial resources for the Centre and the States was reviewed by the Planning

[1] After allowing for repayment of Rs. 20 crores of the U.S.S.R's credit of Rs. 63 crores.

[2] The figures in the following pages are based on *Plan Resources and Outlay*, The Planning Commission, November, 1958.

Commission and the National Development Council (November 1958). The estimates then (1958) made indicated the level of total resources at about Rs. 4,200 crores over the five-year period. It was stressed that efforts should be made to raise additional resources of the order of Rs. 240 crores so as to bring up the Plan outlay to Rs. 4,500 crores. Briefly the position regarding resources was that the Centre and the States were likely to be able to provide during 1959-61 resources of the order of Rs. 1,754 crores, whereas the requirements for reaching a total of Rs. 4,500 crores over the two years amounted to Rs. 2,034 crores. There was thus a short-fall of Rs. 280 crores; Rs. 198 crores at the Centre and Rs. 82 crores in the States; over the Plan period the aggregate outlay could only be Rs. 4,220 crores.

This estimate of the overall resources position took into account an additional taxation of Rs. 12 crores during 1958-59 by the State Governments. It also envisaged an additional taxation of about Rs. 40 crores at the Centre.

Resources at the Centre

Coming to a more detailed account of the resources of the Centre and the States, the distribution of the Plan outlay corresponding to the total resources of Rs. 4,500 at the Centre and States was:

	(In crores of rupees)
Centre	2,512
States	1,988
Total ..	4,500

The Plan outlay at the Centre for 1959-60, reaching the target of Rs. 2,512 crores for the five-year period corresponding to the aggregate outlay of Rs. 4,500 crores for the Plan as a whole, worked out at Rs. 1,088 crores. Besides the Central assistance for the State Plans for the two years was tentatively put at Rs. 470 crores. The problem at the Centre, therefore, was to raise total resources of the order of Rs. 1,958 crores for 1959-61.

The following table sets out the Centre's resources for 1959-61.

TABLE LXXIII

(In crores of rupees)

	1959-60 (Estimates)	1960-61 (Estimates)	Total for 1959-61
	1	2	3
1. Domestic budgetary resources			
(*a*) Balance from current revenue ..	45	55	100
(*b*) Railways' contribution	60	64	125
(*c*) Loans from the public (net) ..	80	90	170
(*d*) Small savings	29	30	59
(*e*) Unfunded debt and miscellaneous capital receipts	16	9	25
Total (*a*...*e*)..	230	248	478
2. External assistance	340	302	642
3. Deficit financing	?	?	?
Total resources	570	550	1120

Here are some brief comments on the above estimates.

(*a*) *Balance from Current Revenue*

The balance from current revenues for 1958-59 was estimated at Rs. 40 crores. In 1959-61 the balance at the existing taxation rates was placed at about Rs. 100 crores.

(*b*) *Railways' Contribution*

The contribution of the Railways towards the financing of the development programme was taken at Rs. 60 crores for 1959-60 and Rs. 64 crores for 1960-61.

(*c*) *Loans from the Public*

Net receipts from market borrowings by the Centre were put at Rs. 80 crores for 1959-60 and at Rs. 90 crores for 1960-61. The repayments of central loans in these years were about Rs. 121 crores and Rs. 113 crores respectively. The

gross borrowing of the Centre was, therefore, to be more than Rs. 200 crores in each of these years; that is, of the same order as in the year 1958-59. The estimates taken for the next two years were thus fairly high.

(*d*) *Small Savings*

According to the estimates given by the State Governments total small savings collections were likely to amount to Rs. 85 crores in 1959-60 and to Rs. 88 crores in 1960-61. On the basis of the arrangements for sharing small savings between the Centre and the States, the share of the Centre in these collections worked out at Rs. 29 crores for 1959-60 and at Rs. 30 crores for 1960-61.

(*e*) *External Assistance*

The carry-over of unutilised external assistance from the First Plan period was Rs. 132 crores. Fresh authorizations of external assistance, including the assistance by the World Bank, amounted to Rs. 977 crores. The total external assistance available was thus estimated at about Rs. 1,100 crores (exclusive of Rs. 238.8 million of P.L. assistance by the U.S.A.) A part of this assistance was for the private sector. For the next two years the gap to be filled by external assistance was estimated at 650 million dollars (about Rs. 310 crores).

(*f*) *Total Resources*

On the basis of estimates given above, the Centre's resources for the next two years (1959-61) worked out at Rs. 1,220 crores—Rs. 478 crores from domestic sources and Rs. 642 crores by way of external assistance. The requirements of resources at the Centre for these two years were estimated at Rs. 1,558 crores. The gap in resources at the Centre thus worked out to Rs. 438 crores.

(*g*) *Deficit Financing*

This gap in resources, viz. Rs. 438 crores, could not, obviously, be met by deficit financing. Deficit financing at the Centre over the first three years was estimated at Rs. 798

crores. Besides, the aggregate budgetary deficit of the States over these three years was estimated at another Rs. 84 crores. Despite the large drawings on reserves of sterling balances and the utilisation of credit extended by the I.M.F., deficit financing on this scale had strained the economy. Prices had risen and the situation further aggravated by the large decrease—of about 6.7 million tons—in food production in 1957-58. The rate of increase in industrial production had also slowed down. The foreign exchange reserves were about Rs. 180 crores, and it was essential to avoid the generation of any inflationary trends which might react adversely on the foreign exchange situation. A resort to deficit financing could, in these circumstances, be only marginal. Not unless food production increased substantially and prices registered a distinct downward trend could deficit financing be contemplated on any significant scale. In view of these considerations, the limit for deficit financing for the years 1959-61 could not be taken at more than Rs. 100 crores a year. Allowing for deficit financing of this order, the gap in resources at the Centre for these years was worked out at Rs. 238 crores.

State Resources

The estimates of outlay furnished by the State Governments placed the Plan expenditure at about Rs. 1,042 crores. The year-wise break-up of this figure is shown below:

	(In crores of rupees)
1956-57	297
1957-58	346
1958-59	399
	1,042

The position for the individual States for each of the three years as compared to the five-year target is indicated in the table on the next page.

The outlay on the Plan likely to be incurred during the three years 1956-57 to 1958-59 was expected to be about 48 per cent of the five-year target of Rs. 2,161 crores originally

TABLE LXXIV

(In crores of rupees)

	Plan target 1956-61	1956-57 (Actuals)	1957-58 (Likely actuals)	1958-59 (Likely actuals)	1956-59 three years	Balance for years 1959-61	Percentage of outlay during the first 3 years to five-year target
Andhra Pradesh	174.8	24.3	29.3	31.2	84.8	90.0	49
Assam	57.9	9.2	9.5	10.7	29.4	28.5	51
Bihar	190.2	25.2	29.2	30.7	85.8	104.4	45
Bombay	350.2	44.4	55.0	76.8	176.2	174.0	50
Jammu & Kashmir ..	33.9	4.4	4.0	5.0	13.4	20.5	40
Kerala	87.0	10.0	13.6	15.5	39.1	47.9	45
Madhya Pradesh	190.9	18.3	27.5	29.7	75.5	115.4	40
Madras	152.3	28.1	30.5	30.5	89.1	63.2	59
Mysore	145.1	14.4	15.7	23.0	53.1	92.0	37
Orissa	100.0	16.8	17.1	61.2	50.1	49.9	50
Punjab	162.6	24.7	28.0	33.8	86.6	76.0	53
Rajasthan	105.3	13.9	15.3	19.0	48.2	57.1	46
Uttar Pradesh	253.1	40.7	46.2	47.5	134.4	118.7	53
West Bengal	157.7	22.1	25.0	29.7	76.8	80.9	49
Total	2161.0	297.2	345.9	399.4	1042.5	1118.5	48

visualised. For the next two years 1959-60 and 1960-61, the balance of outlay in terms of the original target (Rs. 4,800 crores) worked out at about Rs. 1,119 crores.

Outlook for 1959-60 and 1960-61

In the estimates given in the Appraisal document, the States' own contribution to the Plan for 1959-60 and 1960-61 was placed at Rs. 363 crores—Rs. 340 crores from normal budgetary sources and Rs. 23 crores by way of drawing down reserves of cash and securities. Taking Central resources into account, the total resources available for the Plan worked out to Rs. 4,260 crores. It was, however, emphasized in the Appraisal document that the five-year outlay on the Plan should at least be of the order of Rs. 4,500 crores. Accordingly it was suggested that efforts should be made by the Centre and the States to raise additional resources of the order of Rs. 240 crores during the two years, 1959-60 and 1960-61. The States' share of this additional effort was visualised roughly at Rs. 110 crores.

On the basis of the estimates worked out in 1958 the States' resources aggregated to Rs. 394.2 crores for 1959-60 and 1960-61. Of this, Rs. 384.2 crores represented the contribution from normal budgetary sources and the balance of Rs. 10 crores represented a withdrawal from reserves visualised by three States—Madhya Pradesh, Kerala and Mysore.

It was suggested that the States for the last two years of the Plan should raise Rs. 60 crores from:

(*i*) betterment levy;

(*ii*) electricity duties and water rates;

(*iii*) assessment of agricultural lands used for non-agricultural purposes;

(*iv*) assessment of agricultural lands which have acquired an urban character due to completion of development projects; and

(*v*) stepping up of yield from existing taxes by checking evasion and tightening up administration.

The States' share in small savings and borrowings from the public for the two years were placed at Rs. 160 crores —Rs. 120 crores under the former and Rs. 40 crores under the

latter. Including the additional amount of Rs. 40 crores required to be raised by the States during 1959-60 and 1960-61 mainly by intensification of efforts at collecting small savings etc., aggregate accruals from these two sources worked out at Rs. 200 crores.

The main points arising out of the analysis of the resources position of the States presented in the foregoing pages are summarised below:

(*i*) Since the revised outlay on the States' Plan in terms of an overall outlay of Rs. 4,500 crores is Rs. 1,988 crores, and the State Governments expected to incur expenditure of Rs. 1,042 crores on their Plan in the three years, 1956-57 to 1958-59, the balance outlay to be incurred in the coming two years was Rs. 946 crores.

(*ii*) For financing the Plan outlay of Rs. 1,042 crores in the first three years, 1956-57 to 1958-59 the State Governments raised Rs. 390 crores from their own budgetary resources and Rs. 84 crores by liquidation of reserves of cash and securities. The utilisation of Central assistance amounted to Rs. 568 crores.

(*iii*) As against the outlay of Rs. 946 crores left for 1959-60 and 1960-61, the State Governments expected to find about Rs. 394 crores from their own resources. Central Assistance for these two years was placed at Rs. 470 crores. On this basis the State Governments would be able to finance an outlay of Rs. 864 crores during 1959-61.

Outlay on the States' Plan over the five years would thus work out at Rs. 1,906 crores (Rs. 1,042 crores plus Rs. 864 crores). This would mean a short-fall of Rs. 82 crores as compared to the revised Plan allocation of Rs. 1,988 crores. As against the original target of Rs. 2,161 crores, the short-fall would work out at Rs. 255 crores.

Measures for additional taxation so far adopted are estimated to yield Rs. 206 crores during the Second Plan period. For the next two years 1959-60 and 1960-61 the State Governments were expected to raise about Rs. 12 crores by way of additional taxation. About Rs. 10 crores of this would be raised by four States, viz. Uttar Pradesh (Rs. 4.0 crores), Bombay (Rs. 2.6 crores) Madhya Pradesh (Rs. 1.8 crores)

and Andhra Pradesh (Rs. 1.5 crores). The above analysis of the financial resources for the States would work out if the States are able to raise more resources for the plan and the gap of Rs. 82 crores mentioned above could be filled.

The following table gives a comparative picture of Plan outlays (States) as decided originally when the Second Five Year Plan was started and for 1959-61:

TABLE LXXV

(In crores of rupees)

States	Plan Targets 1956-61	1956-57 Actual	1957-58 Likely Actuals	1958-59 Likely Actuals	1956-59	Balance for 1959-60 and 1960-61
Andhra Pradesh	174.8	24.3	29.3	31.2	84.8	90.0
Assam	57.9	9.2	9.5	10.7	29.4	28.5
Bihar	190.2	25.9	29.2	30.7	85.8	104.4
Bombay	350.2	44.4	55.0	76.8	176.2	174.0
Jammu & Kashmir	33.9	4.4	4.0	5.0	13.4	20.5
Kerala	87.0	10.0	13.6	15.5	39.1	47.9
Madhya Pradesh	190.9	18.3	27.5	29.7	75.5	115.4
Madras	152.3	28.1	30.5	30.5	89.1	63.2
Mysore	145.1	14.4	15.7	23.0	53.1	92.0
Orissa	100.0	16.8	17.1	16.2	50.1	49.9
Punjab	162.6	24.7	28.0	33.9	86.6	76.0
Rajasthan	105.3	13.9	15.3	19.0	48.2	57.1
Uttar Pradesh	253.1	40.7	46.2	47.5	134.4	118.7
West Bengal	157.7	22.1	25.0	29.7	76.8	80.9
Total	2161.0	297.2	345.9	399.4	1042.5	1118.5

§ 4. *THE PLAN ACHIEVEMENTS*

We have surveyed the main features of the two Plans. In concluding this chapter a few broad observations may be made to assess the progress achieved by the Plans. Three questions may be answered here: (1) At what rate are we making progress as measured by the national income, both in its totality and in per capita terms? (2). What has been the influence of planning on production in the different

sectors of economy? (3) Are we progressing without sacrificing the stability of the price level?

The relevant statistics regarding national income and per capita income are given in the following table:

TABLE LXXVI

	National income at 1948-49 prices	Per capita net output at 1948-49 prices
1948-49	86.5	246.9
1949-50	88.2	248.6
1950-51	88.5	246.3
1951-52	91.0	250.1
1952-53	94.6	256.6
1953-54	100.3	268.7
1954-55	102.8	271.9
1955-56	104.8	273.6
1956-57	110.0	283.5
1957-58	108.3	275.6

It is possible to draw fallacious and contradictory conclusions from the above figures if we take different base years for purposes of comparison, e.g. it is quite correct to infer that between the two years 1955-56 and 1957-58 the per capita income has gone up only from Rs. 273.6 to Rs. 275.6, hardly an increase worth noticing in spite of vast developmental expenditure (mostly incurred through deficit financing). For a correct appraisal of the situation we must either take 1948-49 or 1951-52 (the first year of the Five Year Plan) as the base year. If we take 1948-49 as the base year it will appear that the per capita income has gone up from Rs. 246.9 in 1948-49 to Rs. 275.6 in 1957-58. However, if we take 1951-52 as the base year we find that the per capita income has increased from Rs. 250.1 to Rs. 275.6.[1]

Let us now examine the volume of industrial and agricultural production; and the quantity of electric energy generated during the Plan periods. The index numbers of industrial

[1] The above changes can be explained to a large extent on account of the vagaries of the monsoon rainfall and its influence on agricultural production.

production of some selected commodities are indicated in the following table:

TABLE LXXVII

1951=100

Items	1952	1953	1954	1955	1956	1957	1958
General index	103.6	105.6	112.9	122.4	132.6	137.3	139.4
Coal ..	105.6	104.5	107.2	111.4	114.9	126.3	132.1
Iron ..	106.3	99.9	107.8	116.1	116.1	126.3	156.3
Sugar ..	134.0	115.8	97.4	143.0	166.5	185.5	175.5
Tea ..	98.6	96.7	102.0	106.2	106.0	106.9	112.0
Cotton textile	102.3	109.1	110.9	111.9	117.5	115.6	108.9
Jute textile ..	107.6	101.1	107.3	118.9	127.3	120.5	123.9
Cement ..	110.7	108.3	137.6	140.4	145.2	175.3	189.9
Iron & Steel ..	102.2	95.7	113.2	113.3	119.4	119.3	119.2

From the above table it will appear that industrial production (as a whole) has increased from 100 in 1951 to 139.4 in 1958. There has also been an all-round increase in industrial production in all the important industries. It is also important to remember that the industrial production index does not as yet reflect the effects of the larger magnitude of investment that has taken place during the last few years in the public and private sectors on account of the time lag which is required between investment and production (an outstanding example being the investment in the iron and steel industry).

Coming to electric energy generated during the period 1951-52 to 1958-59. The following table gives the figures in millions of kilo-watt hours:

TABLE LXXVIII

(ENERGY IN MILLIONS OF KILO-WATT HOURS)

1951-52	5,948.1
1952-53	6,301.4
1953-54	6,876.8
1954-55	7,760.9
1955-56	8,805.8
1956-57	9,877.8
1957-58	11,176.9
1958-59	12,837.0

From the above figures it will appear that the production of electricity has been more than doubled during the period 1951-59.

The overall production of foodgrains in 1956-57 exceeded the previous year's outturn by 4.5 per cent and touched the peak figure of 687 lakh tons in 1953-54. But in 1957-58 because of extremely adverse climatic conditions experienced in different States it declined by 9.8 per cent and 5.7 per cent as compared to 1956-57 and 1955-56 respectively. The all-India index numbers of production of various agricultural commodities and groups of commodities for the six years ending 1957-58 are given in the table on the next page.

From the foregoing account of production it will appear that the rate of progress has been satisfactory. Statistically it would be wholly wrong to describe the economic situation as amounting to stagnation. Rather considering the difficulties through which the economy has passed during the period, it would be safe to conclude that our efforts to increase the national income both in the aggregate and in per capita terms, have been satisfactory. Perhaps the rate of growth, with more favourable circumstances, would have been higher.[1]

One of the most important questions in any developing economy is the degree of stability of prices during the development process. The question is of particular importance in underdeveloped countries where the masses live under conditions of marginal or sub-marginal existence. In comparing the index number of all-India prices it is necessary to keep in mind certain limiting factors, e.g. the huge variations in the levels of agricultural prices in the different States. For example, with 100 as the base for rice prices in 1952-53 the price on July 25, 1959, was 53.1 in Uttar Pradesh and 101.3 in Bihar, in Bombay it was 151 and in West Bengal 147. Similarly the price of wheat was 72.1 in Bihar, 87.5 in Madhya Pradesh; 90.3 in Uttar Pradesh; 106.3 in Rajasthan, and 104 in Bombay.

The choice of the base year is of paramount importance

[1] Incidentally it may be mentioned that the current rate of growth of per capita income is 7.8 per cent in Japan, 3.7 per cent in France, 5.4 per cent in Italy, in Mexico 2.2 per cent, and in Brazil 3.2 per cent.

TABLE LXXIX

INDEX NUMBERS OF AGRICULTURAL PRODUCTION

(Agricultural Year 1949-50=100)

Commodity/Group	Weight	1952-53	1953-54	1954-55	1955-56	1956-57	1957-58
A. FOODGRAINS							
Rice ..	35.3	96.8	118.6	105.8	114.2	119.1	104.5
Wheat ..	8.5	112.7	120.0	135.4	131.3	141.6	116.4
Total Cereals (1) ..	58.3	101.4	120.1	114.5	114.6	119.9	108.3
Gram ..	3.7	109.2	125.4	145.9	138.9	163.2	123.9
Total Pulses (2)	8.6	98.9	112.0	118.5	118.4	124.5	100.9
Total Foodgrains	66.9	101.1	119.1	115.0	115.3	120.5	107.3
B. OTHER CROPS							
Oil seeds							
Groundnut ...	5.7	85.3	100.3	123.6	112.4	124.2	126.3
Total oil-seeds (3) ...	9.9	91.9	103.7	122.6	108.6	118.9	112.3
Fibres							
Cotton ..	2.8	121.0	151.8	163.6	153.9	182.2	182.9
Jute ..	1.4	148.6	100.0	94.8	135.8	138.7	132.3
Total fibres (4) ...	4.5	128.4	132.1	140.4	149.7	171.4	167.2
Plantation Crops							
Tea ..	3.3	115.4	100.6	110.4	108.8	114.1	115.0*
Coffee ..	0.2	125.9	146.5	151.8	176.3	216.3*	121.1*
Rubber ..	0.1	106.1	131.8	127.6	146.1	143.9	145.9*
Total Plantation crops ...	3.6	115.7	104.0	113.2	113.6	120.6	121.8
Miscellaneous							
Sugarcane ...	8.7	101.6	89.5	115.9	119.8	135.3	127.6
Tobacco ..	1.9	91.3	101.5	95.1	112.9	115.9	108.7*
Total Miscellaneous (5) ...	15.1	101.5	97.4	115.8	120.1	128.0	123.1
Total other crops ..	33.1	103.8	104.7	120.9	120.0	130.4	125.7
GENERAL INDEX (All Commodities) ..	100.0	102.0	114.3	117.0	116.9	123.8	113.4

in comparing the movements of agricultural prices. For instance, it is sometimes pointed out that as compared with March 1955, the price of food stuffs has gone up by 40 per cent. Such a statement is misleading because the prices in 1954-55 were so depressed that the Government had to take measures to boost up prices. Similarly, if we take 1951-52 as the base year it could be argued that there has been no change in prices. This inference again is misleading as on account of the Korean boom during that year prices were higher than they would have been under normal conditions.

Finally, it should always be borne in mind that the three main components of wholesale prices—namely foodstuffs, industrial raw materials and manufactured articles, do not show a uniform rise. This is evident from the following figures:

Table LXXX

1952-53=100

	All commodities	Food	Industrial Raw Materials	Manufactures
1953-54 ..	101.2	100.1	107.4	100.7
1954-55 ..	89.6	82.1	94.6	100.1
1955-56 ..	99.2	94.6	110.6	101.6
1956-57 ..	105.1	101.7	116.8	105.4
1957-58 ..	106.1	103.4	112.9	107.4
1958-59 ..	111.7	112.7	115.9	108.2

The base now used for price statistics is 1952-53 which is regarded as the first normal year after the war. With 100 as the index for the base year the general index of wholesale prices (week ending 25th August, 1959) for the whole of India was 117.1. The index of food articles was 121.7, of industrial raw materials 119.4 and of manufactured articles 109.5. An analysis of the components under foodgrains shows considerable variations. Thus the all-India average index for rice was 113; for wheat 96; but for jowar 120 and for bajra 130. Broadly speaking it may be said that the price of foodgrains shows[1] considerable variations since 1952-53.

[1] *See* Speech of Shri H. V. R. Iyengar, Governor, Reserve Bank of India (*Reserve Bank of India Bulletin*, August, 1959, p. 1011.)

We may compare the movements of prices in India with corresponding international statistics. The base adopted by the International Monetary Fund is the calendar year 1953. On that basis the movements of Indian prices *vis-à-vis* prices in other countries is as follows:

TABLE LXXXI

Country	Rise in prices 1953—March 1953	
United Kingdom	+ %	Primary commodities
	+12%	Finished Products
Australia	+ 9%	Domestic goods
Canada	+ 5%	
France	+25%	
West Germany	+21%	Agricultural
	+ 5%	Industrial
India	+6.1%	
Japan	— 2%	
U. S. A.	+ 9%	

It would appear from the above figures that in the international setting our price movements have come off pretty well. Nevertheless, a very close watch is necessary in order that higher prices should not be a source of distress to the millions of people who are living on the margin of subsistence. Hence extreme caution is necessary in making use of deficit financing. The revenue side of Public Finance and public expenditure should be utilised to promote both greater economic equality and vigorous economic growth. The success of planning lies in strengthening the economic base of democracy.

XX

LOCAL TAXATION

INTRODUCTORY

In the studies on Provincial finance in India, inadequate attention has been paid to the problems of the financial relationship between the Provincial Governments and local authorities. The administrative and financial problems of Provincial Governments and local authorities, though closely knit together, are treated in isolation. The financial policy of the Provincial Government has no relation to that of local authorities. The tax policy of each local authority is also separate and has no relation to that of the rest.

The disadvantages of such an uncontrolled and un-coordinated tax-system are obvious. It has created inequalities of tax burdens between individuals and between one district and another. The widely different tax rates imposed by municipalities and district boards on goods and merchandise entering their limits (e.g. in the shape of octroi) has made it impossible to know the exact burden which trade and industry have to bear or the relative burden on different commodities. This un-coordinated system has also resulted in a lack of efficiency and economy in the administration of local services. Lastly, it has not led to a healthy development of local self-government, towards what Sidney Webb calls that national minimum of efficiency in local services, which is now regarded as indispensable in the interests of the nation as a whole.

The object of this chapter is to consider briefly the present situation and the lines along which the financial relations between State Governments and local authorities may be co-ordinated, so that a greater element of efficiency, economy and harmony may be introduced into the tax system of the country. With this end in view, the financial problems of local authorities may be studied in two parts:

(*i*) the problem of areas and functions and the resulting inequality in tax burdens; and

(*ii*) the principles and methods to be followed by the State Governments in rendering help to local authorities.

§ 1. *THE PROBLEM OF AREAS AND FUNCTIONS*

Causes of Decay of Village Communities

To achieve efficiency in local tax administration and to distribute the tax burden equitably, a scientific delineation of local areas is necessary. The size and area of the local authorities has been determined in India, as in most other countries, by political and historical factors. In pre-British days the village was an autonomous body; its local self-government functions were in the hands of village communities. This autonomous character of village life gradually disappeared under British rule owing to the establishment of local civil and criminal courts, the present revenue and police organization, the increase of communications and the growth of individualism.[1]

This process of transformation was completed when the East India Company, to facilitate the collection of land-revenue, divided the country into new regional units (districts) and placed them under the charge of Collectors. These radical changes touched the root of local self-government in India. This changed atmosphere, surcharged with individualism, led to the final disappearance of those village communities which had formed the basic unit of local self-government in the country. The village panchayat, the executive body of the village communities, sanctioned by both ancient law and custom, became an impotent body on account of the rising tide of individualism and the increasing importance of civil and criminal courts.

At the present time, beginning with the Corporations, e.g. of Bombay, Calcutta and Madras, we have several layers of Governmental units consisting of municipalities, district boards, taluk boards, notified areas and cantonments, down to the panchayats. The exact number of these units varies in different States and also within different districts of the

[1] *Report of the Royal Commission on Decentralization*, Cmd. 5460, 1908.

same State. But generally for rural areas the district board is the unit of local self-government.

The Area Served by the District Boards is too Large

The area served by the district boards is unquestionably too big. Whereas in England there is one local body to every four square miles and in France to every six square miles, in India there is a local board to 1,494 square miles.[1] The unwieldy size of the areas under district boards has very important consequences in the raising of taxes and in the efficient administration of local services.

First, size has an important bearing, as the Taxation Enquiry Committee observed, on the question of taxation, since unquestionably the facility for raising contributions for local purposes increases as the size of the unit of taxation decreases.[2] With an inadequate and corrupt staff, the chances for fraud, tax evasion and embezzlement become extraordinarily high in India. Moreover, the lack of proper facilities in raising taxes because of too large areas results in maldistribution of tax burdens between the different classes of rural population. The large landholders and village traders, who also perform the work of indigenous bankers, do not contribute their fair share.

Secondly, the district boards are not able to pay adequate attention to all the different parts of their large areas. The Council of a small English borough, observes Professor Cannan, finds difficulty enough in reconciling or disregarding the demands of different parts of its area for road repairs, lighting, parks, and suchlike things.[3] A district board in India, covering an area of more than 1,400 square miles, necessarily finds it extremely difficult to reconcile the claims and counter-claims of the thousands of villages under it.

Thirdly, the present areas of the district boards are unsuitable for the efficient and economic performance of the services undertaken by them.

[1] See *Report of the Indian Taxation Enquiry Committee*, 1924-25.

[2] Ibid. p. 290. The Committee observed: 'In rural areas the jurisdictions of the local bodies are too large from the fiscal point of view', p. 322.

[3] Cannan, *The History of Local Rates in England*, P. S. King, 2nd edition, pp. 174-5.

Optimum Size of Local Bodies

An inquiry into the character of the services performed by such local authorities leads us to consider the optimum size of such bodies, in order that the unnecessary waste in both the raising of revenue and the provision of a given quantity and quality of service, may be reduced to a minimum. In the absence of such knowledge the best efforts of the most capable administrators may not produce desirable and satisfactory results. For, 'if the governmental organization is defective,' says Professor Lutz, 'it becomes impossible to measure the relation between efforts and results, and immense sums may continue to be poured into certain administrative channels, only to disappear without a trace, like the river that flows into desert sands.'[1]

Theoretically, to improve the relation between resources and functions in the case of local authorities two courses of action are open:

(*i*) jurisdictional changes; and

(*ii*) re-allocation of functions between units which can perform them in the most efficient way.

To this we come in Section 2.

§2. *VILLAGE PANCHAYATS*

Revival of Village Panchayats

Jurisdictional maladjustments cannot be easily corrected. The best way to correct such maladjustments, with the least disturbance to the existing administration, would be an active revival of village panchayats. From time immemorial the Indian village panchayats have been the basic unit of administration. Their revival would increase efficiency, economy and good administration in local areas and would facilitate the reform of maladjusted tax-burdens and the introduction of a rational policy for the determination of the aggregate public expenditure, great or small, in directions which would avoid waste and increase efficiency.

The Royal Commission upon Decentralization in India (1908), clearly visualized the importance of local govern-

[1] Lutz, *Public Finance*, p. 110.

mental units, and in order to arrive at a better level of administration in the field of local self-government, strongly recommended the desirability of starting such bodies in the following terms:

> We are of opinion that the foundation of any stable edifice which shall associate the people with administration must be the village, as being an area of greater antiquity than administrative creations, such as tahsils, and one in which the people are known to one another, and have interests which converge on definite and well-recognized objects like water supply and drainage. It is probable, indeed, that the scant success of the efforts hitherto made to introduce a system of rural self-government is largely due to the fact that we have not built up from the bottom.[1]

The administration of village panchayats as basic units of local self-government is now regulated by separate enactments in most of the States. It may be pointed out that the policy of fostering village panchayats is included as a 'directive principle of State policy'. Article 40 of the Constitution, provides that 'the State shall take steps to organize village panchayats and endow them with such powers and authority as may be necessary to enable them to function as units of self-government.'

Recently there has been a tendency for the revival of village panchayats in most of the States. In Madras the village Panchayats Act of 1950 (Madras Act X, 1950) removed village panchayats from the operation of the Madras Local Boards Act of 1920. The new Act gives additional powers to the panchayats. Under it the panchayats have a distinctive legal position. The new Act divides panchayats into two classes—Class I, those with an estimated population of 5,000 and over, and having an estimated annual income of not less than Rs. 10,000; and Class II, panchayats other than those in Class I with a minimum population of 500 persons.

In U.P. the village panchayats are governed by the U.P. Panchayat Raj Act, 1943 (U.P. Act XXVI of 1947). Under this Act all adult residents in a village are incorporated under the name of a *Gaon Sabha*, and the *Gaon Panchayat* is

[1] Cmd. 4360, 1908, par. 699.

the executive Committee of the Sabha. 35,000 village panchayats for 1,10,000 villages in the State have been established under the Act.

In Bihar the village panchayats are governed by the Bihar Panchayat Raj Act, 1947 (Bihar Act VII of 1948). The panchayat under this Act is a body corporate consisting of all adult residents of the area for which a Gram Panchayat is established. The village panchayat is the policy-laying and budget-making body, whereas the executive functions are performed by an executive committee of which the head (known as the *Mukhiya*) is directly elected. The *Mukhiya* (headman) appoints the members of the executive committee from among the members of the Gram Panchayat.

Re-allocation of Functions between District Boards and Village Panchayats

The revival of village panchayats should be followed by a policy of re-allocation of functions between district boards and such units. The present area of the district boards being too large, the transfer of the administration of services such as education, village sanitation and drainage, registration of vital statistics, vaccination, prevention of diseases of animals and destruction of insects and pests, to village panchayats, would undoubtedly increase efficiency and economy in their administration. On the other hand, the provision of hospitals, building of highways, paths and bridges, improvement of agriculture, development of rural industries, and what is broadly conveyed by the term 'rural reconstruction' should be left to district boards.

It should not, however, be forgotten that this policy of decentralization of functional readjustments accompanied by financial grants, must be accompanied by centralized control to achieve good results. The district boards, in the interests of a well-regulated, co-ordinated and uniform policy, must be given power of control and supervision over the panchayats. For similar reasons, the services performed by the district boards must be properly supervised by the State Governments.

This policy of functional re-allocation, accompanied by

centralized control, raises a number of important problems. We shall, however, consider only two aspects of these problems; First, as the finances of local authorities are low all over the country, methods are suggested to increase their resources; secondly, to supplement their inadequate resources, the way in which the State Governments should help and supervise, is indicated.

In most of the Acts recently passed to organize village panchayats, their functions are divided into 'obligatory' and 'discretionary' categories. The allocation of functions is not uniform in all the States. However, broadly speaking, among the important obligatory functions the supply of water for domestic use; cleaning of public roads, drains, *bunds* (embankments), tanks, wells (other than tanks and wells used for irrigation) and other public places or works; sanitation, and conservancy, prevention and abatement of nuisances, may be mentioned.

Among the discretionary functions, the construction and maintenance of public latrines, markets and slaughter-houses; laying out of playgrounds and public gardens; planting trees; establishment of village libraries and reading rooms, relief of the destitute and the sick; control of fairs; opening and maintaining public landing places; cart-stands and cattle-sheds; registration of births and deaths, opening and maintaining elementary schools and dispensaries, may be stated.[1]

Finances of Panchayats

Broadly speaking, for discharging the above functions the panchayats in most of the States have been given financial resources as follows:

There are four taxes which are compulsory for every panchayat viz. the house tax, the vehicles tax, the profession tax and a duty on transfer of property.

In addition to the above compulsory taxes the panchayats may levy with the sanction of the Government the following three imposts: Land cess; Tax on Agricultural Land; Fees on commercial crops bought and sold in the village.

[1] See the *Report of The Local Finance Enquiry Committee*, 1951, pp. 284-5.

A large variety of fees may also be levied by the panchayats, e.g. a fee for temporary occupation of village sites, roads and other public places; markets; cart-stands; dangerous and offensive trades; licensing of brokers and commission agents; slaughter-houses; permits for different works or acts etc.

Finally there are three heads under which contributions are recoverable from the District Boards viz.

1. In respect of markets in the village which are classified as District Markets;
2. In respect of ferries managed by District Boards;
3. Contribution, if any, in respect of opening and running elementary schools.

In each case, however, the Government fixes the scale or amount of contribution payable by District Boards.

Mehta Committee Report[1]

Under the Second Plan the number of panchayats is expected to increase to 244, 564 by the end of 1960-61. The panchayats, however, have not been making satisfactory progress on account of party factions, local jealousies and corruption. Perhaps one of the most important weaknesses in their organization is that the panchayats stood by themselves as isolated units of local Government without having any relation whatsoever from a superior organising unit—say at the district level. The result has been that people are losing faith in the organization of panchayats and it is considered necessary to revitalize a single representative democratic institution by a series of vigorous institutions which should take charge of all aspects of development in rural areas. Such bodies should be statutory, partly elective, comprehensive in their duties and functions, equipped with necessary executive machinery, well co-ordinated and in possession of adequate financial resources. The question of revitalizing panchayats in all their aspects was considered by the *Mehta Committee Report*. The Committee, in its considered opinion, recommended that if the panchayat movement was to succeed in the country it was to be correlated with the community programme so

[1] The account given in the following pages is based on the Balwant Rai Mehta Committee.

that each could lend support to the other and implement, in a short period, the various aspects of rural economy. The Committee recommended the establishment of three tiers of democratic institutions to operate simultaneously in order that the process in democratization may function on healthy lines and the people may get the maximum benefit out of it. These three tiers are (1) the village panchayat; (2) the panchayat *samiti*; and (3) the *zila parishad* (district). An account of the functions and finances of these tiers is given in the following pages.

Panchayats

The constitution of the panchayat should be purely on an elective basis, but that there may be a provision for the co-option of two women members and one member each from the Scheduled Castes and Scheduled Tribes on conditions similar to those prescribed for the panchayat *samiti* (as stated below).

Sources of Revenue

The principal sources of revenue of the panchayat, the Committee recommend, may be as follows:

1 Property or house tax as is considered locally suitable;
2 Tax on daily, bi-weekly or weekly markets, bazars, *hats*, or *shandies*, whether located on private land or otherwise;
3 Tax on carriages, carts, bicycles, *rickshaws*, boats, and pack animals;
4 Octroi or terminal tax;
5 Conservancy tax;
6 Water rate;
7 Lighting rate;
8 Income from cattle-pounds;
9 Fees to be charged for registration of animals sold within the local area, for the use of *sarais*, slaughter-houses, etc.;
10 Grants from the panchayat *samiti* on lines similar to those suggested for grants from Government to panchayat *samitis*.

In the case of some of these taxes it may be necessary to prescribe a compulsory minimum rate.

As far as possible, the village panchayat should be used as the agency for the collection of land revenue; this arrangement has been tried and found successful in some States. It may be necessary to grade the panchayats on the basis of their performance in the administrative and developmental field. For instance, the rates at which it is imposing taxation, the success with which it collects its taxes and the extent to which it displays active interest in developmental activities would be the criteria on which such grading is based. Only those village panchayats which satisfy a certain basic minimum of efficiency will be invested with the power of collecting land revenue. In all cases, however, such power will be restricted to amicable collection as distinct from *arbitrary* collection. In addition the Committee recommended that the village panchayat should be entitled to receive from the panchayat *samiti* a statutorily prescribed share of the net land revenue; such a share may rise to three-quarters.

The budget of the village panchayat should be subject to scrutiny and approval of the panchayat *samiti*; and the panchayat *samiti* will provide such guidance to the village panchayat in all its activities as the latter may need. The chief officer of the panchayat *samiti* will exercise the same powers in regard to the village panchayat as the Collector and District Magistrate will exercise in regard to the panchayat *samiti*. On the other hand, no village panchayat should be superseded except by the State Government, which will, however, do so only on the recommendation of the *zila parishad*.

Functions

The Committee was of the opinion that the village panchayat should receive substantial grants from the panchayat *samiti* and that its budget should be approved by the latter. It may be desirable to prescribe a smaller number of compulsory functions to the panchayat and permit them to undertake any other developmental work with the approval of the panchayat *samiti*—such approval being automatic with the approval of the budget. The Committee recommended that the compulsory duties of the village panchayat should be: (*i*) provision of water supply for domestic use, (*ii*) sanitation,

(*iii*) maintenance of public streets, drains, tanks etc., (*iv*) lighting of the village streets, (*v*) land management, (*vi*) maintenance of records relating to cattle, (*vii*) relief of distress, (*viii*) maintenance of panchayat roads, culverts, bridges, drains, etc., (*ix*) supervision of primary schools, (*x*) welfare of backward classes and (*xi*) collection and maintenance of statistics. In addition to the above functions it will act as the agent of the panchayat *samiti* in executing any schemes of development or other activities. It will appear that some of the above functions also find a place in the duties assigned to the panchayat *samiti*, but the provision that the village panchayat budget has to be approved by the panchayat *samiti* will guard against any duplication of activities.

One of the main reasons for the failure of panchayats in some areas has been the intensification of factions and feuds, often also of separatism arising out of caste distinctions. The system of electoral contests at village level has often added to these. The Planning Commission's Panel on Land Reforms considered this particular problem and observed that 'efforts should be made to ensure that elections to the village panchayat are made, as far as possible, by the general consent of the people and the bitterness and hostility created by election campaigns avoided. The membership of the village panchayat should be regarded as an opportunity for service to the people which should be undertaken by the best men in the village rather than as a means of obtaining power and prestige. At the same time, it is necessary to bear in mind the dangers which are inherent in unanimity arrived at under pressure. Such unanimity may actually, over a period, develop below the ground conflicts which could have worse effects than the usually passing conflicts in an open election.'

Panchayat Samiti

Coming to panchayat *samitis*. The Committee tentatively proposed that the panchayat *samiti* should be constituted by indirect elections from the village panchayats. The panchayats within the block area can be grouped together in convenient units which can be *Gram Sewaks*' circle and the panches of all the panchayats in each of these units should elect from

amongst themselves a person or persons to be a member or members of the panchayat *samiti*. Such elected representatives should be about 20 in number in each panchayat *samiti*. These elected representatives will co-opt two women who are interested in work among women and children. Where the population of Scheduled Castes exceeds 5 per cent of the total population of the panchayat *samiti* area, one person belonging to a Scheduled Caste shall be co-opted; and similarly one member of a Scheduled Tribe. In Scheduled Areas suitable safeguards should be provided to ensure that the tribal population is adequately represented. Where members of these groups have already been elected to the panchayat *samiti* in prescribed numbers, no co-option may be necessary. In addition, the panchayat *samiti* may co-opt two locally resident persons, whose experience in administration, public life or rural development may benefit the *samiti*. The panchayat *samiti* should function for 5 years.

Functions

Since the urgency of decentralisation is the field of development it is necessary that the panchayat *samiti* should begin to operate with the least possible delay. Its function should cover the development of agriculture in all its aspects, including the selection of the seed, its procurement and distribution, the improvement of agricultural practices, provision of local agricultural finance with the assistance of the Government and of the co-operative banks, minor irrigation works, the improvement of cattle, sheep, goats and poultry, the promotion of local industries, the supply of drinking water, public health and sanitation, medical relief, relief of distress caused by floods, earthquakes, scarcity, etc., arrangements in connection with local pilgrimages and festivals, construction and repair of roads which are of local importance (other than village panchayat roads), management and administrative control of primary schools, the fixation of wages under the Minimum Wages Act for non-industrial labour, the welfare of backward classes and the collection and maintenance of statistics. In the case of States where district boards or *janapada sabhas* have undertaken the management of high schools;

these can be transferred to the panchayat *samiti* concerned. In addition, it may act as the agent of the State Government in executing any special schemes of development or other activities in which the State Government might like to delegate its powers to this local authority. The Committee strongly urged that, except where the panchayat *samiti* is not in a position to function in any particular matter, the State Government should not undertake any of these or other development functions in the block area.

Finance

One of the most important reasons for the comparative lack of success of our non-urban local self-governing bodies is their exceedingly limited and inelastic resources. Since most of the entire development work of rural areas will be the charge of the panchayat *samiti*, the Committee recommended that the following sources of income be assigned to them:

1 A statutorily prescribed percentage of land revenue collected within the block area in the anti-penultimate year; where this arrangement is likely to cause a very substantial disparity in the incomes of the panchayat *samitis*, the alternative is to divide equally between all of them a portion of the State's land revenue; we suggest that in either of these cases the land revenue assigned to the panchayat *samiti* and the village panchayat should not be less than 40 per cent of the States' net land revenue;

2 Such cess on land revenue, water rate for certain minor irrigation work, etc., as is leviable under the various Acts but excluding special cesses like the sugar-cane cess; we suggest that the minimum rate of cess should be prescribed by statute but the panchayat *samiti* should be encouraged to recommend the levying of a cess at a higher rate, so that this could be considered a local taxation measure;

3 Tax on professions, trades, callings and employment. We would recommend that this should be levied not by the village panchayat nor by the small municipality but by the panchayat *samiti* itself;

4 Surcharge on duty on the transfer of immoveable property;

5 Rents and profits accruing from property, e.g. ferries, fisheries, etc. within its jurisdiction, where these ferries lie across roads constructed and maintained by panchayat *samitis*;

6 The net proceeds of tolls and leases on roads and bridges, etc., in the panchayat *samitis*;

7 Pilgrim tax;

8 Tax on entertainments, including amusements;

9 Primary education cess;

10 Proceeds from periodical fairs and markets, bazars, *hats* and *shandies* other than those held more frequently than once a month whether located on private land or otherwise;

11 A share of the motor vehicles tax;

12 Voluntary public contributions;

13 Grants made by Government.

In the case of some of these taxes it may be necessary to prescribe a compulsory minimum rate. To make the panchayat *samitis* demonstrably useful to the village community and to ensure their continued success, it is necessary that the State Government should give adequate grants-in-aid; some of these grants will be unconditional, others earmarked for certain purposes but without further conditions, some others earmarked for certain purposes but on a matching basis. The result will be that each panchayat *samiti* will have an assured income of a certain size and will attract grants-in-aid from Government by producing its own fresh resources. In making these grants the State Government will, no doubt, take into account the special economic backwardness of certain areas and give them appropriately larger grants.

The panchayat *samiti* will need guidance in technical as well as administrative matters; but this guidance should, under no circumstances, result in excessive regulation or control; nor should such guidance or advice be considered as interference. With this object the technical officers of the panchayat *samiti* should not be under the technical control of the corresponding district level officers but under the administrative and operational control of the chief administrative officer. The annual budget of the *samiti* may be approved by a higher and more experienced body on which

Government also will have to be represented. In order that the *samiti* may display initiative in its function and vigour, its budget, though scrutinized by the district officer, should be approved by the *zila parishad*.

Zila Parishad—Functions

From the account given above it will appear that in the matter of developmental activities village panchayats and the panchayat *samitis* would be the main local bodies. Having assigned to them functions in various fields, the Committee recommend the abolition of district boards.[1] The Committee thus observed that the district board, the district school board and the *Janapada sabha* become superfluous, as local interest, supervision and care, necessary to ensure that the expenditure of money upon local objects conforms with the wishes and need of the locality, are provided by the panchayat *samiti*, which would be an optimum body from the points of population and area. The present functions of district boards will be performed with greater efficiency by the panchayat *samiti*. But to ensure the necessary co-ordination between the panchayat *samitis*, a *zila parishad* (of which the members will be the president of the panchayat *samitis*, all members of the State legislature and of the Parliament representing a part or whole of a district whose constituencies lie within the district,—district level officers of the medical, public health, agriculture, veterinary, engineering, education, backward classes welfare, public works and other development departments) should be established. The Collector will be the Chairman of this *parishad* and one of his officers will be the Secretary.

While discussing the functions of the panchayat and *samiti* we have indicated the functions which the *parishads* are expected to perform; for instance, it will examine and approve the budgets of the panchayat *samitis*. Where funds are allotted by the Government for the district as a whole, their distribution between the various blocks will be made by the *parishad*; it will co-ordinate and consolidate the block plans, annual as well as quinquennial; where grants for special purposes

[1] The States of U.P. and Bihar have abolished district boards.

are needed or demanded by panchayat *samitis*, these also will be consolidated and forwarded to the Government by the *parishad*. It will also generally supervise the activities of the panchayat *samiti*

Some of the State Governments (U.P. and Bihar) have already partially (or fully) implemented the recommendations of the *Mehta Committee Report*. It is expected that in the near future a new picture of local government in rural areas may emerge in which there will be the fullest possible co-operation in the functioning of local authorities and community programmes. The establishment of the panchayat *samiti* with a wide devolution of powers by the State Government has to be an act of faith in democracy. It is, however, necessary to keep in view that it is only when the three tiers of the scheme, viz. the village panchayat, the panchayat *samiti* and the *zila parishad*, operate simultaneously, that we will get the maximum out of it.

§ 3. *MAIN SOURCES OF INCOME OF LOCAL AUTHORITIES*

Income of Municipalities

The sources of income of local authorities may be grouped under four heads:

1 Taxes on trade
2 Taxes on property
3 Taxes on persons
4 Fees and licences

1 *Taxes on Trade*

Octroi. Municipalities place too much reliance on indirect taxes. Octroi, terminal-taxes and tolls form their most important sources of revenue. All these are ancient and primitive taxes and have their historical basis in the benefit of the market in which producer and trader required safety to carry on their market operations in isolation. This was justified in unsettled times but is now hardly a legitimate basis for their imposition.

These duties are levied on goods and merchandise entering

municipal limits. In the form in which they are levied in India they offend against all the canons of taxation. They are uncertain in their incidence. They not only hamper the trade and industry of the country but fall with inequitable weight on poorer classes whose necessaries of life form the main items of such tax receipts.

Lord Stamp summed up the defects of octroi as follows:

> In my judgment, both theoretically and on the result of experience, no country can be progressive that relies to an extent upon octroi, which has nearly every vice.

The popularity of these taxes, in spite of these grave defects, is due to the fact that as their incidence is shifted it becomes very difficult to determine who ultimately bears the burden of the tax. The tax is 'wrapped up in the price of the commodity'. The collection of octroi through the agency of the railway has removed some of the administrative difficulties, and the municipalities have in this way also transferred the odium of collection to the railway company.

Apart from these features it is to be regretted that the Government of India and the State Governments have not so far exercised an effective control over the trade of the country. Customs barriers, which are serious obstacles to international trade, cannot always be easily avoided, on account of political, national or vested interests. Octroi and other international transit duties are merely customs in disguise. It is unfortunate that even under the Constitution the position of octroi remains, more or less, what it was under the Act of 1935. The Local Finance Committee reluctantly recommend octroi on practical grounds, and suggest that there should be in each State a model schedule for octroi approved by the State Government and that departures from that schedule should not be permitted by any subordinate authority, except with the previous approval of the State Government.[1] Such a schedule should prescribe the list of articles and the maximum rates permissible, in order that wide variations in the rates may be avoided. At present the schedule of rates varies from State to State and even from one local body to another within the same State in respect

[1] See the *Report on The Local Finance Enquiry Committee*, 1951, p. 153.

of the same article. They further recommend that in framing the model schedule the rates on the necessaries of life should be kept as low as possible. Meanwhile, the State Governments should see that:

(*i*) Octroi is low and as nearly uniform as possible.
(*ii*) It does not bear unfairly on through trade.
(*iii*) The cost of collection is reduced.
(*iv*) Its administration is improved.

2 *Taxes on Property*

(*a*) *Municipalities*. Property tax is levied by municipalities in India for four important purposes:

(*i*) a tax for general purposes on lands and buildings;
(*ii*) a water and drainage tax;
(*iii*) a lighting tax;
(*iv*) a conservancy or scavenging tax.

Property tax is of major importance in Madras, West Bengal, Bihar, Orissa and Assam. In Bombay the rates of house tax in many municipalities are far lower than in municipalities of corresponding size in Madras. In Punjab and Uttar Pradesh it is of comparatively minor importance. It is levied in a few municipal areas and where levied the rate is very low. There are great possibilities of developing this source in these two States. In Madras, West Bengal, Assam and Orissa the property tax is levied by all municipalities. In Bombay, the house tax is levied by all municipalities, except by three municipalities, i.e. Ahmadabad, Gudguddapur and Ulvi. In Bihar, house tax is levied by 54 out of 57 municipalities. In Uttar Pradesh, it is levied only in 33 out of 110 municipalities.[1]

It is, however, to be regretted that while the tendency in local finance of most countries is towards the replacement of indirect by direct taxes, in India direct taxation of property has not made much progress in municipal finance. The octroi, with all its unpalatable features as we have seen, still dominates the field of local finance. In taxation of houses the two cardinal principles of benefit and ability are harmoniously combined. Taxation of houses covers the payment for definite

[1] See the *Report on The Local Finance Enquiry Committee*, 1951, p. 71.

services, such as street-lighting, drainage, communication, etc., which 'benefit' property. House property also affords a rough but tangible measure of the owner's (or occupier's) capacity to pay.

The main reason for the low yield of taxes on houses is the reluctance of municipal commissioners, dependent on the suffrage of the rate-payers, to increase or introduce the house tax. The conclusions with regard to the unhealthy features of municipal administration may be expressed in the words of the Bengal Government: Municipal finance will continue to present a problem of perplexing difficulty so long as the municipal bodies display a reluctance to tap adequately the resources at their disposal. Unwillingness to face the unpleasant duty of fresh and enhanced taxation, laxity in the recovery of taxes, current as well as arrears, and disregard of financial canons, retard the path of municipal progress.

(*b*) *District Boards' Local Fund Cess*

The sheet anchor of the revenue of district boards is a cess on land called the local rate or the local fund cess in different States. It is collected through Government agency along with the land revenue and credited to the district board funds after deducting the cost of collection.

The basis of the assessment of the cess varies from State to State. Table No. LXXXII shows the rates and basis of assessment.

As regards the persons who pay the cess, the practice varies from State to State. In ryotwari areas it is levied upon the landholder, who may or may not shift it when sub-letting the land. In the Punjab, the local rate is payable by the landlord, but in case where the land is held by an occupancy tenant at a favourable rent, the landlord may realize a share of the rate from the tenant. In the permanently settled areas of Madras the cess was collected from the landholder who, however, was entitled to receive one-half of it from his tenant. In Bengal, the landlord pays the entire amount of the cess, but is entitled to recover from the tenure-holders the entire amount, less an amount determined at half the rate of the cess for each rupee of rent payable by the latter. The cultivating tenant

TABLE LXXXII

States	Name of Cess	Basis of Assessment	Rate
1	2	3	4
Madras	Land Cess	Of annual rent value of land which shall be the full assessment payable plus water rate in the case of ryotwari and inam land and annual rent in the case of others.	Two annas in the rupee.
Bombay	Local Fund Cess	Of land revenue. ...	Three annas in the rupee
West Bengal	Road and Public Works Cess	(*a*) Of annual value of lands or of annual net profits from mines, quarries, tramways, etc. (*b*) On land used for tea, coffee and cinchona cultivation.	Rupees ten per acre.
Uttar Pradesh	Local Rate	Of the annual value of land which is defined as twice the land revenue payable.	9-3/8 per cent compulsory maximum.
Punjab	Do	Do	One anna to four annas per rupee.
Bihar	Road and Public Works Cess	(*a*) Of annual value of lands. ... (*b*) Of the annual net profits from mines and quarries.	2 annas in the rupee
Orissa	Local Cess	(*a*) Of the annual value of lands or annual net profits.	From 2 annas to 4 annas per rupee
	Land Cess	(*b*) Of the Kamilzama assessed in every zamindari and Malguzari village in Sambalpur.	12 per cent

is liable to pay to the person to whom his rent is payable one-half of the cess.

The local rate forms the most important source of revenue of rural bodies in India. The tax is economical to the board as it is collected along with land revenue. Where it is levied at a flat rate it is not proportional to the ability of the rate-payer. In areas where it is based on acreage it is not proportional to the taxable capacity of the lands. Nevertheless, the tax, as it is used for purposes of local improvement, benefits the property of the tax-payer. The tax is based on the benefit theory of taxation.

3 *Taxes on Persons*

Among the important taxes on persons a tax on circumstances and property, and a tax on professions, trades and callings may be mentioned. A tax on circumstances and property may either be an alternative or a concomitant to a house tax. In small and decaying towns, house tax is often a fallacious index of the circumstances of the owners or occupiers. Hence a tax on circumstances and property, in place of a house tax, is levied. In some cases a tax on circumstances and property is a useful supplement to a low house tax.

The present position regarding the levy of profession tax is governed by Article 276 of the Constitution. The Article runs as follows:

(1) Notwithstanding anything in Article 246, no law of the Legislature of a State relating to taxes for the benefit of a State or of a municipality, district board, local board or other local authority therein in respect of professions, trades, callings or employments shall be invalid on the ground that it relates to a tax on income.

(2) The total amount payable in respect of any one person to the State or to any one municipality, district board, local board or other local authority in the State by way of taxes on professions, trades, callings and employments shall not exceed two hundred and fifty rupees per annum; provided that if in the financial year immediately preceding the commencement of this Constitution there was in force

in the case of any State or any such municipality, board or authority a tax on professions, trades, callings or employments the rate or the maximum rate of which exceeded two hundred and fifty rupees per annum such tax may continue to be levied until provision to the contrary is made by Parliament by law, and any law so made by Parliament may be made either generally or in relation to any specified States, municipalities, boards, or authorities.

(3) The power of the Legislature of a State to make law as aforesaid with respect to taxes on professions, trades, callings and employments shall not be construed as limiting in any way the power of Parliament to make laws with respect to taxes on income accruing from or arising out of professions, trades, callings and employments.

Under the Constitution the old limit of Rs. 50, under the Government of India Act, 1935, has now been raised to Rs. 250, which undoubtedly is a welcome change in the powers of the local bodies to levy profession tax. In view of the changed circumstances the State Governments should now advise local bodies to revise the previous schedules of profession tax, so as to increase their resources.

The position in some of the major States regarding the tax on professions may briefly be summarised as follows:

In Madras, it is levied by all municipalities, district boards and several panchayats. The income from this source is substantial. In view of the raising of the limit to Rs. 250 the Madras Government have advised local bodies to revise their previous schedules up to the maximum permissible.

In Bombay, no municipality levies profession tax as such, but some of them levy small taxes in the form of licence fees on specified trades and callings which are subject to municipal control. This tax is also levied by four or five district boards. The income from this source is negligible. The Government of Bombay are of the opinion that the profession tax can never be a source of much income owing to the disproportionately large collection charges.

In Uttar Pradesh, there are two taxes which are akin to the profession tax:

(1) A tax on trades, callings, etc. which is assessed on the annual income in ascending scales. This tax is levied only in 13 municipalities out of 110 and yields Rs. 12 lakhs annually; and

(2) A tax on circumstances and property, which is at present levied by 12 municipalities and 29 district boards. In rural areas agricultural income is exempt from taxation and the maximum rate is 4 pies in the rupee on income, subject to an aggregate maximum per assessee. District boards depend on this tax to a much greater extent than municipalities. They derive an income of Rs. 12 lakhs per annum from this source.

There is no provision for the levy of a profession tax in the U.P. District Board Act. Only certain trades and callings can be licensed. The panchayats have got powers to levy such a tax.

In West Bengal, a profession tax is levied in the City of Calcutta and other municipalities. A profession tax is levied in rural areas, but the income goes to District School Boards under the Primary Education Act. The Union Boards levy what is called a Union rate, which is their principal source of income and is assessed on the lines of a tax on circumstances and property subject to a maximum of Rs. 84.

In Bihar municipalities, there is at present a tax on circumstances and property which is levied in substitution of a tax on holdings. There is no such tax in rural areas.

In Assam, the profession tax is a provincial tax and is not levied by any local body.

Fees and licences are numerous and are levied for a variety of purposes. Fees for specific services (e.g. scavenging), licence fees on carriages and animals, and licence fees for the regulation of offensive and dangerous trades are levied by almost every municipality in India.

The income from fees and licences could be substantially increased if municipal trading is encouraged in India. The scope for municipal trading is vast, and if the municipalities follow a policy of capital development, the income under this head is capable of expansion.

§ 4. *FINANCIAL CO-ORDINATION BETWEEN THE LOCAL AUTHORITIES AND STATE GOVERNMENTS*

Need for Grants-in-aid

The preceding pages have made it clear that the present financial arrangements of the local authorities are unsatisfactory and need to be changed. Perhaps nothing is more urgently needed in the field of local financial reform than a change in the financial relations of the local authorities and State Governments. Any such change on scientific lines should result in (*i*) an increase of primary and secondary education, (*ii*) increased facilities for medical treatment, (*iii*) an advance in public health activities, development of means of communication and transportation, and (*iv*) an extensive development of rural reconstruction.

On what lines should a change in the present financial arrangements between the local authorities and State Governments proceed? The subject is full of difficulties. Any radical suggestion would necessarily invite criticism. We may, however, learn lessons from the financial history of local authorities in England and put in a plea for the adoption of grants-in-aid devised to start a new kind of relationship between the State Governments and the local authorities. The case for grants-in-aid as a measure for the equalization of burdens and for placing local finance on a sounder footing has been made by Sidney Webb on four grounds. They are:

(*i*) Grants-in-aid are necessary, in the first place, to prevent an extreme inequality of burden between one district and another.

(*ii*) They are needed to give weight to the suggestions, criticism, and authoritative advice by which the central authority seeks to secure greater efficiency and economy of administration.

(*iii*) The third reason for grants-in-aid is that they furnish the only practicable method, consistent with local autonomy, of bringing to bear upon local administration the wisdom of experience, superiority of knowledge, and breadth of view which, as compared with the administra-

tors of any small town or any rural area, a central executive department cannot fail to acquire, for carrying into effect the general policy which Parliament has prescribed.

(*iv*) The fourth reason for grants-in-aid is that only by this means can we hope to enforce on all local authorities of the kingdom that national minimum of efficiency in local services which we now see to be indispensable in the national interest.[1]

Advantages of Grants-in-aid

As pointed out previously, the State Governments have not so far exercised sufficient care, attention, and control in the supervision of local authorities. It is rather unfortunate that people in India think that the greater the direction and control exercised by the State Government the less the field for local autonomy. This, however, is a short-sighted view. To quote Sidney Webb once again: 'A century of experience has demonstrated that it is undesirable for local authorities to be subject to no administrative control whatsoever from a central authority, for them to be left without independent inspection or audit, without access to centralized experience and specialist knowledge, without any enforcement of the minimum indispensably required for the common weal, and without mitigation of the stupendous inequality of local rates that complete autonomy involves.'[2] No local authority exists by itself. Its financial and administrative policies profoundly affect the trade, industries, tax burden and life of people living in other areas. Thus in the interests of a uniform and co-ordinated policy grants-in-aid form the most efficacious lever of central control to harmonize the relations of various local authorities *inter se*.

Again the administrative wisdom and wider experience of the State Government can best be made available for local authorities through a system of grants-in-aid. Local authorities with local fields of vision, may follow a policy which though it may be beneficial to the locality, may be detrimental to the wider interest of the main as a whole.

[1] Webb, *Grants-in-Aid*, Ch. II, pp. 15-23.
[2] Ibid. p. 18.

Grants-in-aid in England before 1888 were 'in most cases devised', says Lord Balfour of Burleigh, 'with a view to guiding local authorities in the desired direction'. The wayward policy followed by local authorities in India can be largely controlled and guided in the right direction through a judicious system of grants-in-aid. And as grants must always bear some relation to the cost of local services, they afford a lever for improving local administration, both in regard to efficiency and economy.

The equalization of tax burdens and the enforcement of a 'national minimum' in locally administered services cannot be attained under the present financial arrangement in India. Poor backward districts possess highly inadequate resources and need larger expenditure for the spread of education, provision of hospitals and improved sanitary facilities, and the development of means of communication and transportation. Under such conditions, says Sidney Webb, 'to leave each local authority to pay for its own sanitation, its own schools, its own roads and bridges, its own sick and infirm, and its own aged and poor would mean that some districts would have to incur a rate in the pound ten or even twenty times as great as others.'[1] Hence, in order that poor undeveloped areas may come up to a common minimum standard of adequacy and efficiency of local services, without gross inequality in tax burdens on individuals, a system of grants-in-aid becomes a supreme necessity.

Lastly, at the present time, with the development of means of transportation and communication and the advancement of modern science, national life is becoming more closely knit together. Since no Chinese Wall exists between local authorities, national life is profoundly affected by the ignorance, negligence or poverty of an inefficient or a poor area. As Dr. Finer aptly remarks: 'No area is bacteria-proof, none is bacteriologically self-contained; no area is criminal-proof, none is burglariously insulated.'[2] Hence, in a progressive society the central authority must see that the standard of services performed by local authorities does not fall below

[1] Webb, op. cit. p. 17.
[2] Finer, *English Local Government*, p. 28.

the national minimum. If a local authority cannot come up to a certain standard in the efficiency of its services the central authority must come to its help and raise efficiency. The ultimate responsibility for the moral and material development of the people, must rest with the nation. People living in poor backward areas should not be denied the minimum civic amenities available to those living in rich areas.

In view of the flagrant disregard of the principle of the 'national minimum' in Indian local self-government, Sidney Webb's classic argument for grants-in-aid is worth extensive quotation.

> We cannot allow Little Pedlington to be free, if it chooses, to have as much small-pox and enteric fever—not to say cholera and bubonic plague—as its inhabitants choose to, rather than take preventive measures which they dislike. We have equally no reason to put up with the horrible bad roads which are all they may wish to pay for. If they are permitted to bring up their children in ignorance, to let them be enfeebled by neglected ailments, and to suffer them to be demoralized by evil courses, it is not the Little Pedlingtonites alone who will have to bear the cost of destitution and criminality thus produced. Hence, modern administrative science is forced to recognize that we are all, in the plainest sense, 'members of one another'.[1]

Grants-in-aid: their Need in India

The history of grants-in-aid in England reveals that they originated to help the rural classes upon whom, with the development of industrialization and commercialization, the increased burden of taxation began to weigh too heavily. The basic and primary reason for the growth of grants-in-aid, says Dr. Finer, was 'the decline of agriculture and an unjust local tax system'.[2] In India, under the Reforms of 1919, land revenue became the mainstay of provincial finance. It is difficult to find what percentage of it was spent upon rural education, medical relief, sanitation, building of roads and bridges and rural development in general. But the backward

[1] Webb, op. cit. p. 24.
[2] Finer, op. cit. p. 429.

condition of rural areas, lack of proper facilities for education, medical relief and sanitation and the inadequate development of country roads, all unmistakably prove that very little of it was returned to the people from whom it was taken. 'The land revenue in India', observed the Taxation Enquiry Committee, 'is still largely a direct impost levied almost solely for state purposes. Only a very small fraction of the tax collected from the cultivators is actually used for rural development, and the illiterate ryot is therefore unable to recognize the benefit which he derives from the direct tax he pays.'[1]

Hence in India grants-in-aid must, in the interests of a better distribution of the tax burden between different social classes and different localities, form an integral part of the financial system of the country. Nothing would do more to rehabilitate rural finances, relieve unjust and oppressive tax burdens and place local finance in its proper relation to state finance than a system of grants-in-aid.

Principles of Grants-in-aid: Percentage Grants and Block Grants

The principles upon which grants should be distributed between the local authorities remain to be considered. One important conclusion may at once be stated. Lord Balfour of Burleigh was of the opinion that 'the contribution given should bear some relation to the cost of national service.'[2] The local authorities may receive grants based upon a definite proportion of the expenditure of a service, or a block grant, i.e. a fixed grant of money without the reciprocal obligation of matching half or two-thirds of the cost of the service, as the case may be.

Percentage grants are easy to calculate and flexible in nature. They offer a powerful stimulus to some local authorities to increase their expenditure, as part of their expenditure will be borne by the higher authority. They can be controlled easily by the granting authority without undue interference

[1] *Report of the Taxation Enquiry Committee*, p. 79.
[2] *Royal Commission on Local Taxation*, Cmd. 638, 1901. Separate Recommendations of Lord Balfour of Burleigh, p. 71.

with the autonomy of the local authorities. But the greatest defect of percentage grants, in a country where the economic conditions of different local authorities differ vastly, is that they perpetuate inequalities of tax burdens. The percentage which will provide rich areas with wasteful expenditure will not permit the minimum of civic service in poor areas.

A case for percentage grants is, however, sometimes made out on the ground that since local expenditure is voluntary, a local authority which fails to take the best advantage of the central authority is wilfully negligent of its duty and deserves no encouragement. The fallacy of such an argument is clearly shown in cases where the failure of the local authority to take such help is due not to its negligence but to its poverty. It is exactly for improving the efficiency of such local authorities that grants-in-aid are meant.

Lord Balfour of Burleigh in his separate note to the Royal Commission on Local Taxation, 1901, advocated the system of block grants.[1] Such grants, he said, should be given for each service taken as a whole and in the distribution of such grants some attempt should be made to equalize the burden of local rates. The principles upon which the grants should be distributed between the local authorities should take into consideration the cost of the services assisted and the economy and efficiency shown in their administration. Further, with a view to equalizing the burden of onerous rates between the rate-payers of different areas, such contributions should be based upon the principle of ability.

The system of grants-in-aid in India should be approached in the light of these principles. With vast inequalities of local resources and differences in economic conditions, a system of grants-in-aid is the only practicable method of equalizing tax burdens and introducing the maximum efficiency in the administration of national services. The following general principles for the distribution of grants-in-aid may be classified:

(i) Grants should only be given for 'national' services.[2]

[1] *Royal Commission on Local Taxation*, op. cit. p. 73.
[2] *See* (*a*) Grice, *National and Local Finance*, p. 326.
(*b*) Cmd. 638, 1901, pp. 73-85.

(*ii*) Grants should bear some relation to the expenditure upon such services. The amount granted to each local authority should depend upon the varying circumstances of each area. In no case should the grant exceed one-half of the total expenditure.

(*iii*) In order to minimize the inequality of tax burdens in the provision of national services, the distribution of grants should be so arranged that the poorer districts should be treated with greater liberality than the rich ones.

(*iv*) The State Government should be given extensive powers to withhold the grants if a certain degree of efficiency is not reached in their administration.

(*v*) In all cases the State Government should exercise effective control and supervision over the local authorities through an annual inspection and audit.

(*vi*) Grants should not be given for purposes which will cause an actual rise in the value of immoveable property of the residents of the local area.[1]

(*vii*) In order that the local authorities may be able to chalk out a programme of uniform development, grants should be fixed for a period of not less than five years. They should be subject to periodic revision after taking into consideration the improvements made by each local authority during the last period.[2]

Local Indebtedness Conditions under which Local Authorities should Borrow

Another important problem affecting the financial relations of local authorities and State Governments is that of local indebtedness. Local debts in the case of western countries have become a common feature of local finance.[3] The expensive character of the activities of local authorities, especially in improving means of communication, sanitation, education, clearing of slums and other social services, had made it impossible for them to balance their budgets with taxation alone.

[1] *See* Professor Cannan's distinction between 'onerous' and 'beneficial' services. 'Beneficial' services are those which cause an actual rise in the value of immoveable property.

[2] For the principles of local finance, *see* Ch. I.

[3] Grice, op. cit. p. 329.

Large amounts of money are borrowed to finance such development activities.

In India the problems of local indebtedness, except in the case of Corporations, have not so far come into prominence. But with the growth in the activities of local authorities, local indebtedness is bound to play a greater role in local finance. Hence it may be worthwhile to lay down certain principles which the State Government should take into consideration in regulating and controlling the problem of local indebtedness. These may be stated as follows:

(*i*) Loans should not be allowed to balance budgets. To avoid the unpopularity of increased taxation local authorities might sometimes resort to the easier method of balancing the budgets through loans. Such a practice would place a heavier burden on future tax-payers.

(*ii*) Loans should only be permitted for projects of real and permanent improvements which cannot be financed out of ordinary revenues.

(*iii*) Municipalities and district boards, in the interests of general financial security, should not be allowed to raise loans independently. Each loan application should be made to the loan department of the State Government. The purpose of the loan, the rate of interest, must all be definitely stated in the loan application.

(*iv*) Provision should be made for a sinking fund.

(*v*) If the loan is required for productive works the income from such works should be set apart from the General Budget and should be utilized for the repayment of capital. In other cases provision for the repayment of capital must be made out of the General Budget through increased taxation.

(*vi*) The State Governments should always balance the interests of present and future generations of tax-payers. It is in the adjustment of the burden between the present and the future that the function of the central authority, says Dr. Grice, as the preserver of financial honesty, the alleviation of immediate hardship and the guardian of the interests of future citizens is brought into play.[1]

[1] Grice, op. cit., p. 329.

(*vii*) Except in the case of Corporations, the State Governments should advance loans directly to local authorities. Instead of advancing from the State revenues, the State Governments should start a Local Authorities Loan Account and loans should be made out of this account. Such a system would have several advantages. It would keep the State revenues separate from local debts. It would restrict, control and keep down local debts. The legislative and administrative regulations made in connection with the Local Authorities Loan Account would provide safeguards against vast borrowing by local authorities. It would not disturb the general rate of interest. Lastly, it would enable the local authorities to borrow easily and cheaply.

Conclusions

The changed basis of financial relationship between the State Governments and local authorities outlined in the course of this chapter would fill an important gap in the financial system of the country. In the place of the present uncontrolled and un-coordinated tax system resulting in inequalities of tax burdens, we should have a carefully adjusted system of local taxation in harmony with the national system of taxation. The need for such a change was never so urgent as it is now. The increasing tax burden on trade and industries in recent times demands a more unified and controlled system of taxation than ever before. Moreover, since the same individual has to pay taxes to different tax authorities, central, State and local, it is essential that if the tax burden is to be distributed on a more equitable basis, a greater element of uniformity should be introduced. A policy of functional reallocation coupled with the system of grants-in-aid would introduce equity, economy and efficiency in local finance and administration.

XXI

SUMMARY AND CONCLUSIONS

Tendencies in State Finance and Policy

The scope of public finance in India, as in most other countries, expanded greatly during the second half of the nineteenth century. So long as the East India Company was engaged in war, the outlay for military purposes exceeded all other expenditure. The economic, social and cultural needs of the masses were largely neglected. After 1858 there were added to the strictly military functions of the Company certain functions which grew out of the Government's famine policy, for example, the building of railways and construction of irrigation works. In course of time, particularly after the Viceroyalty of Lord Curzon (1899-1905), the Government aimed at a new economic policy and undertook many constructive economic and social services. Hence in addition to maintaining law and order the Government was charged with the responsibility of assisting actively the agricultural, industrial and social development of the country.

After Independence, the two main objectives of economic policy are: a better standard of life for the people and social justice. These principles are derived from the Directive Principles of State policy as embodied in the Constitution. These Principles envisage equality of opportunity, the right to work, the right to an adequate wage and a measure of social security for all citizens. A Welfare State is the avowed goal of our Constitution. To achieve this new order, the Five-Year Plans have been launched. Upon the successful outcome of the Plans depends the future economic pattern of the country.

The expansion of Governmental activity in India has affected the system of State finance in four distinct ways. First, the expansion of social, economic and cultural expenditure needed additional revenues. Second, to secure efficient and economical administration the necessity for a satisfactory distribution of functions between the Government of India and the States became imperative. Third, with the re-allocation

of functions the necessity for the adjustment of revenues to needs arose. Fourth, it was felt that additional revenues could only be raised by entrusting the State Governments with the responsibility of raising a portion of their revenues.

The history of State finance described in Chapters II, III, IV, V and VI illustrates these four tendencies.

The increasing financial decentralization from 1870 till the passing of the Government of India Act, 1935 is the product of these tendencies.

The Constitution has fundamentally changed the scope of federal finance in India. This change has been brought about as a result of the working of three forces, namely:

1 the removal of the constitutional limitations under which the financial system was working under the Act of 1935;
2 the changes in the economic functions of the State; and
3 the economic unity of the country brought about by the integration of the former Indian States into the Union.[1]

The Indian Constitution is a centralized federal constitution. The financial character of the Constitution has made the Centre definitely stronger than it was even under the Act of 1935. Perhaps this was necessary under the new political set-up of the country to check the working of separatist tendencies. The States, in view of their limited resources, must always look forward to the Centre for financial aid and thus follow the advice of the Union in all important financial and political matters.

The most remarkable tendencies in Provincial finance during the Reforms period 1919-35 may be summed up as the stagnation of revenues, rising expenditure and unbalanced budgets. Most Provincial Governments feverishly pursued the policy of attempting to balance their budgets at all costs. Most of them fought shy of increasing old tax rates or introducing new ones. A policy of rigorous economy was followed; expenditure on public works was curtailed; all salaries were reduced, and expenditure on education and social services was also cut.

[1] See my *Economic Aspects of the Indian Constitution*, Orient Longmans, 1958, (Second edition.)

The obvious failure to take advantage of certain other sources of revenue, especially the taxation of agricultural incomes, death duties, or sales tax was partly responsible for the financial plight of the Provinces. The lack of capital expenditure for the promotion of the economic development of the country crippled the future finances of the Provinces. This timid negative policy of balancing the budgets resulted in decreasing the purchasing power of the people and stagnation of revenue.

The recent fiscal policy of the Government is in contrast to what followed prior to Independence, when the normal policy was one of maintaining a balanced budget with a low rate of spending and light taxes. This new policy resulted in the buoyancy of revenues of the Government of India which, despite increasing expenditures, has resulted in surpluses in the revenue part of the budget. The revenue surpluses have helped to finance part of the capital expenditure.

Perhaps the most striking change in the fiscal policy of the Government has been the change both in the magnitude and the pattern of expenditure in the public sector. With the launching of the Five-Year Plans the total expenditure on development incurred by the Central Government and Railways and State Governments has increased enormously. The major items include multi-purpose river valley projects, irrigation, electricity, housing and other civil works, industrial development (e.g. steel projects) and compensation to landlords. The increase in the activities in the public sector has now made it necessary to present a commercial budget for the State undertakings.

Besides, much expenditure has also been incurred to improve agriculture and the economic condition of cultivators. The State agricultural departments have introduced improved types and varieties of crops and improved methods of cultivation. The co-operative movement has been strengthened and great assistance has been rendered to the cultivators in relief of indebtedness. The facilities for education have been increased. Efforts have been made to provide better medical aid, and the State Governments are largely responsible for improvements in public health and sanitation. But all these

have merely touched the fringe of the problems. A more vigorous policy is needed to emancipate the poverty-stricken millions of India from an under-nourished and disease-ridden existence. Is it possible?

Fundamental Obstacles to the Development

State finance after Independence has entered a new stage. But the fundamental obstacles to the development of social services have remained unchanged. Hence the intensity and difficulty of the problems of public finance has also not changed. I am convinced that no change in the system of allocation of resources between the Centre and States, retrenchment and search for new taxes can result in a rapid advancement of the conditions of the life of the people unless certain fundamental obstacles are removed. Three such obstacles occur to me.

In Chapter I an idea of the size and population of India was given. The task of a Government in face of the vastness of the area, teeming population, its predominantly rural character and its dependence on the monsoon and mass illiteracy is particularly difficult. Hence financial stringency has been the universal complaint of the States and it has seriously hindered the pursuit of a more constructive social or economic development policy. My own conclusion is that a rapid advancement in the economic or social life of India, through any system of public finance is not possible unless the abnormal increase in population is stopped. My assertion is supported by Dr. Anstey's observation, that 'it must be definitely recognized that general prosperity in India can never be rapidly or substantially increased so long as any increase in the income of individuals is absorbed not by a rise in the standard of life, but by an increase in the population.'[1] Second, the power of the Government in India is overrated. Owing to the absence of the spirit for social services in India all schemes for social and cultural development must always come from the Government. The Government of a country, however strong its finances may be, must necessarily find it a heavy task to

[1] Anstey, op. cit. p. 474. *See* Chapter 1.

inaugurate rapid social uplift. Perhaps if the national leaders now direct their attention towards social works, many of India's most pressing present-day economic and social problems would be solved. In most other countries the task of social reform services is at least in part deliberately assumed by the people themselves. Therefore, it can be concluded that unless the people assume at least a part of the responsibility for finding solutions for a more extensive development of social services, reform must necessarily be slow.

Thirdly, the proper place and functions of local authorities in the national tax-system have not been fully realized. The local authorities have not developed their financial resources and have not undertaken responsibility for the organization and development of social services. Instead of using local resources for the provision and improvement of education, public health and medical relief or the improvement of rural and urban means of transportation we have depended upon our State revenues. We reformed and expanded our State tax-system, leaving the local taxes as they were, and upon this flimsy foundation we wanted to build a programme for the reorganization and expansion of social services. As a consequence, lack of local initiative has been one of the major forces retarding the progress of social services.

Possible Lines of Progress

We will now explore the most desirable lines of progress in State finance. It may be mentioned that, in spite of the development of large-scale industries and foreign and internal trade, over two-thirds of the people still depend upon agriculture, so that the relations between the State and the tenants need urgent revision. No single factor in public finance, whether a change in commercial or tariff policy, or encouragement and organization of large or small-scale industries, can compare in importance with the revision of land policy. I must emphasize here that the abolition of zamindari alone would not improve the condition of the peasantry. Security of tenure and freedom to cultivate without restrictions and harassment from the State are no less important for the prosperity of the cultivators.

In conclusion it can be said that the future of State finance depends not only upon the discovery of new taxes, and the inauguration of particular schemes of development or new lines of policy, but in the main upon fundamental social reforms and reorganization, directed towards controlling the size of the population, breaking up the existing over-rigid social stratification, stimulating enterprise and energy, promoting education and replacing the forms by the spirit of religion. It is thus and thus only that State finance can be utilized as an engine to help in providing a decent existence in an unkind world for the hunger-stricken millions of India.

Another line of progress to which attention has been drawn in Chapter XX is the need for financial co-ordination between the State Governments and local authorities. The time has passed when it was possible to treat the problems of State and local finances in isolation. Today, the slender resources of the States and local authorities must be carefully husbanded if in the end budgets are to be balanced. It is only by pooling the resources of the States as a whole that the inequalities in the resources of poor areas can be minimized and an attempt can be made to reach a national minimum in the provision of essential social services. A carefully planned financial system and thorough-going reorganization of State and local finances appears to be the most desirable line of progress to stimulate education and provide better medical and public health services.

Perhaps one of the most important needs of the day is the control over expenditure. There is a popular feeling that the Government is not exercising proper care in controlling expenditure and disbursing officers sometimes do not follow the prescribed rules of accounts. Be that as it may, the fact remains that the audit reports point out numerous instances regarding financial irregularities. The long list of cases usually given in each year's audit report indicates that there is considerable room for improvement in the standards of control in some departments.

It is easy to lay down rules of expenditure; it is very difficult to see that the disbursing officers are spending public revenues properly. The following general principles which have for

long been recognized should be strictly followed by all Government officers spending public revenues:

(1) that the expenditure is not *prima facie* more than the occasion demands, and that every Government servant exercises the same vigilance in respect of expenditure incurred from public moneys as a person of ordinary prudence would exercise in respect of expenditure of his own money.

(2) that no authority exercises its powers of sanctioning expenditure to pass an order which will be directly or indirectly to its own advantage.

(3) that public moneys are not utilized for the benefit of a particular person or section of the community.

To control public expenditure eternal vigilance by the legislature and the Finance Department is absolutely necessary. The legislature through the proper functioning of the Estimates Committee and the Public Accounts Committee can exercise an effective control over the spending departments of the Government. The British Parliamentary Committee on Estimates has been performing a useful function in examining public expenditure. 'The Committee on Estimates constitutes the best parliamentary check on inefficiency in the Public Services yet devised in the United Kingdom.'[1] Again, the Public Accounts Committee of the British Parliament minutely examines public expenditure after the accounts have been audited and reported on by the Comptroller and Auditor-General. The Chairman of the Public Accounts Committee is a member of the Opposition and the party balance of the Parliament as a whole is reflected in it. The double check acts as a highly efficient control against inefficiency and faulty planning.[2] At the Centre the Public Accounts Committee (consisting of fifteen members) and the Estimates Committee (with twenty-five members) are doing good work in exercising some control over public expenditure. Similar committees have been constituted in some of the States, but in most cases the members of the legislature, through these committees, do not exercise effective control over public expenditure.

[1] Mrs. Hicks, op. cit. pp. 17-18.
[2] Ibid. p. 17.

The control of the Ministry of Finance over the spending departments needs still further improvement. The Finance Minister should act towards the estimates of the spending department as *advocatus diaboli*. As the guardian of the people's purse and as the man who will have to find the money, it is for him to see that no service is included that is not essential, and that every service that is included is provided for in the most economical manner.[1] The Finance Minister should be the watchdog of economy.

Finally, to increase the efficiency check on expenditure at the administrative level, the establishment of Organization and Method Departments in all the departments on British lines has become absolutely necessary. The Organization and Method Departmental officers should work in liaison with an organization and method service in the Ministry of Finance.

New Technique of Budget Accounting

Another important question to which little or no attention has been paid is the necessity for presenting the nation's accounts on a new basis. With the phenomenal growth of governmental expenditure and the State performing a large number of services which were formerly undertaken by private enterprise a new technique of budget accounting has now become absolutely necessary. The traditional manner in which the budget has so far been presented for over half a century has now become out of date and needs reshaping on the lines of modern business in those sectors where the State is performing the commercial activities. The traditional system of budget accounting worked very well so long as the functions of the State for which it presented accounts were purely administrative. Every expansion of public enterprise has resulted in the breakdown of the traditional practices. The obvious conclusion is that for the commercial activities of the State we need a 'commercial budget'. As this is not being done the Government is not presenting a correct picture of its revenue and expenditure position to the nation.

Let me illustrate this by a simple example. The Ministry of Food has been presenting accounts for its department in

[1] Hilton Young, E., *The National System of Finance*, 1936, pp. 22-3.

a manner which makes budget accounting highly defective. Suppose the Ministry buys Rs. 100 crores worth of food during 1947-48 which it does not sell during that year, but adds it to stock; it disposes of that stock during 1948-49 with a profit of 10 lakhs of rupees. The present system of budget accounting simply shows Rs. 100 crores as expenditure for 1947-48; it reckons Rs. 100.10 crores as receipts in the second year. The result of the accounting process may be that the budget surplus during 1947-48 may be turned into a deficit budget and the deficit budget of 1948-49 may become a surplus budget. The above is a purely trading transaction and in actual business accounting Rs. 100 crores would be carried over as stock during 1947-48 and in 1948-49 Rs. 100 crores would be brought in as stock from the last year and Rs. 10 lakhs would be shown as profit during the second year.

The presentation of the budget on a commercial basis seems to be the only solution to get rid of the difficulty. Referring to the English system of budget accounting on which the Indian practice is based, Professor Hicks has observed that the traditional system of budget accounting is now in a state of ruin and the main reason of its collapse is the development of trading services which do not fit into the traditional categories. The trading services are much more like businesses than the Government departments of the traditional type; like businesses they borrow and lend, and like businesses they accumulate real assets the stock of which rises and falls. To apply the conventions of the traditional exchequer to the trading services makes nonsense. But because there has been no systematic attempt to reformulate the traditional principles to meet the new situation, the failure to fit those principles to the trading services has had a whole series of dire consequences.[1]

The difficulties indicated above suggest that a new technique of budget accounting should be developed in order that the exchequer accounts mirror a correct picture of Government revenues. The new system should be based on the trading account system to enable the Government finances to be put

[1] Hicks, J. R., *The Problem of Budgetary Reform*, Oxford University Press, 1948. For some of these views, I am obliged to Prof. Hicks.

upon a business accounting basis. But there is one difficulty in this proposal. Some of the departments of the Government which we may for the sake of convenience call administrative departments, e.g. education, law and order, are not trading departments and hence an application of the commercial accounting system would be distinctly unsuited in their case. Perhaps the best solution to promote orderliness in Government accounts would be to divide all the activities of the Government into two parts, which we may call administrative departments and trading departments. It may be difficult to draw this distinction in some particular places so that a revision of the demarcation may be necessary from time to time.

However, the above classification would result in changing the present state of budget accounting. For the administrative departments the traditional system should continue and all the present set of rules should be applied in its full vigour. The budget for these departments should be presented in the traditional form and the Government finances should depict a surplus or deficit of a completely conventional character. Thus for the administrative departments the finance department is a paymaster, for the trading departments it is a bank. The accounts of the Government in relation to the trading departments should be modelled on the lines of a bank and the Government should exercise the same control over their expenditure which a bank exercises over its clients.

The above proposal may perhaps be efficiently carried out if the treasury functions themselves are divided into two parts: its functions towards administrative departments and its functions towards the trading departments, the former being of an administrative character, the latter being those of bankers. Further the banking division of the treasury should, as is the case in all commercial undertakings, distinguish the financial position of the trading departments into three types of accounts: namely, (1) trading account, (2) profit and loss account, and (3) capital account.

The overall budget of the Government should consist of (1) the revenue accounts, and (2) capital accounts of the

administrative and trading deparments each separately pointing out the distinctive character of the accounting position in their respective fields.

In conclusion, it may be said that the financial position of the Government of India and the States is sound. The nation has survived the unusual financial difficulties in the post-partition period. The keynote of the fiscal policy of the Government since 1947 has been high Government outlay on development together with high taxation. Since the Government is determined not to embark on a course of deficit financing beyond a certain limit, high taxation must remain the normal feature of Indian fiscal policy for years to come.

The finances of the country have been very well managed through the conservative monetary policy followed by the Reserve Bank of India which acts as the guardian alike of the State and Central finances. Under the financial leadership of the able Finance Ministers of the country, confidence in the Government's ability to steer the country, through its present difficulties is evident in the rapid economic development of the country.

APPENDIX I

NOTES ON TAXATION[1]

In this Appendix we propose to discuss briefly some of the important principles in the pure theory of public finance. Although there is no country in which the whole system of taxation is logically worked out from first principles,[2] yet it can hardly be denied that a knowledge of the leading principles of taxation would greatly help practical financiers in tackling the problems of public finance in a scientific spirit. Hence an examination of some of the principles may not be out of place here.

Benefit Theory of Taxation[3]

Historically, the benefit and ability theories of taxation have led to the introduction of proportional and progressive taxation. The benefit principle of taxation was based on the protection which the individual enjoyed under the State. Since protection was regarded as the chief function of the State, taxes were regarded as insurance premia which an individual paid to the State for the security of life and property. From this was derived the theory of proportional taxation. In the beginning the theory of proportional taxation was rigid, proportional taxation being taken to mean proportional to income, irrespective of the size of the income. This conception was soon modified by the idea that income below a certain minimum should be exempt. The conception of the minimum of subsistence led to the introduction of the principle of degression in taxation.

The benefit theory is open to two main objections. First, if each person is required to contribute to the State in proportion to the benefit derived by him, two important questions arise: What are the benefits derived by him? And how can they be measured? The measurement of benefits (for example, defence) and their evaluation are not easy problems to solve. Secondly, even if it were possible to overcome this difficulty, the benefit principle would result in gross inequalities of tax burdens, for social expenditure (e.g. elementary education) confers much more benefit on poorer people than on those who are better off. If this principle were strictly

[1] The above notes on taxation may be of some help in understanding the principles and problems of federal finance.

[2] Lord Stamp, op. cit. p. 24.

[3] For a discussion of the 'Ability' and 'Benefit' theories of taxation, *see* Seligman, *Progressive Taxation in Theory and Practice*, 1908.

applied, many social services which mainly benefit the poorer classes would have to be foregone, as the necessary revenue could not be raised by taxation of those classes. But it is socially necessary and advantageous to provide such service. The principle, therefore, breaks down in practical application.

Nevertheless, the benefit principle has wide application in certain fields of public finance. The principle comes into play under betterment schemes, fees and local taxation. The Government often does things, in a business capacity, which could equally be performed by private enterprise. The public utility services render a special service to individuals which demand a payment in return. Such payments, called fees or prices, for public services sometimes contain an element of taxation.

Ability Theory of Taxation

With the change in the functions of the State the benefit theory proved to be unsatisfactory. In a well-known passage of the *Wealth of Nations*, Adam Smith has set forth the functions of the State. According to him the Sovereign has only three duties to attend to: first, the duty of protecting society from the violence and invasion of other independent societies; secondly, the duty of protecting as far as possible every member of the society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice; and thirdly, the duty of erecting and maintaining certain public works and certain public institutions which can never be in the interest of any individual or small number of individuals to erect and maintain.

To provide funds for the State to perform these functions Adam Smith enunciated the four celebrated maxims of taxation, briefly known as the maxims of 'Ability', 'Certainty', 'Convenience' and 'Economy'. The maxim of ability is a principle of taxation, the three others are administrative rules respecting taxes. The maxim of ability runs as follows:

> The subjects of every State ought to contribute towards the support of the Government as nearly as possible in proportion to their respective abilities, i.e. in proportion to the revenue which they respectively enjoy under the protection of the State.

The principle of ability led to progressive taxation.

The Principle of Minimum Sacrifice

The Smithian principle of ability has been differently interpreted. Property or income or both are selected as the tests of the tax-payer's

ability. These are objective standards. John Stuart Mill transformed the objective standard into the subjective measure of 'sacrifice'. 'Equality of taxation,' maintained Mill, 'as a maxim of politics means equality of sacrifice.'[1] The ability of the individual to pay taxes was measured by that proportion of his income the loss of which would impose upon him an equal sacrifice as compared with his neighbour.

The doctrine of equality of sacrifice was reinvigorated by Professor Edgeworth, who dropped the conception of equal sacrifice and introduced the idea of minimum sacrifice. 'The use of minimum', he says, 'instead of equal sacrifice enables us to pierce the sort of metaphysical mist which has been raised by the question: Why should the principle be adopted? The question is not embarrassing to those who regard minimum sacrifice as a deduction from the greatest happiness principle which can guide legislation on a great scale.'[2]

Following Edgeworth, Professor Pigou discards Sidgwick's principle of equity—the principle that similar and similarly situated persons ought to be treated equally—in favour of the principle of least sacrifice. He declares that 'we may properly assert that least aggregate sacrifice is the one ultimate principle of taxation.'[3]

The principle of least sacrifice is based on the principle of diminishing marginal utility, which tells us that the utility of money decreases with its further increases to its possessor. The abstraction of Re. 1 from Rs. 10,000 will not inflict the same sacrifice as its abstraction from Rs. 100. Thus concludes Professor Pigou:

> In order to secure least aggregate sacrifice, taxes should be so distributed that the marginal utility of the money paid in taxation is equal to all the payers. If the utility of the last penny paid by A were less than that of the last paid by B, a reduction of sacrifice could be secured by transferring a part of B's assessment to the shoulders of A. Thus, the distribution of taxation required to conform to the principle of least aggregate sacrifice is that which makes the marginal—not the total—sacrifices borne by all the members of any community equal.[4]

The principle of least aggregate sacrifice carried to its logical conclusion would involve lopping off the tops of all incomes above the minimum income and leaving everybody, after taxation, with equal incomes.[5]

[1] Mill, John Stuart, *Principles of Political Economy*, Bk. V, Ch. II, section 2.
[2] *Economic Journal*, 1897, p. 566.
[3] Pigou, A.C., *A Study in Public Finance*, 1929, pp. 60, 61.
[4] Pigou, op. cit. pp. 75-6.
[5] Ibid. p. 70.

On theoretical grounds the principle of least sacrifice is not open to much criticism. In its practical application to the logical conclusion, as stated above, the principle involves three important considerations, namely:

(*i*) Its effects on the distribution of wealth.
(*ii*) Its effects on production.
(*iii*) Political practicability.

The lopping off of all incomes above the minimum income assumes the complete powers of the State to redistribute wealth, so as to rectify inequality of fortune. Acting on this principle, if we have to raise Rs. 500 crores for State expenditure, we should lop off the top Rs. 500 crores of individuals' incomes until we have the amount. This may result in cutting down all incomes to, say, Rs. 2,000, below which none would pay taxation. Suppose, having cut down all incomes to Rs. 2,000 the State needs another Rs. 100 crores, then on the principle of least sacrifice incomes between Rs. 1,500 and Rs. 2,000 will again be entrenched upon, and all incomes may be further reduced to less than Rs. 1,500.

The economic consequences of the principle to the dynamic life of the community would be disastrous.[1] The incentive to saving and enterprise would be lowered and the accumulation of capital would be retarded. For why should an industrialist, when incomes are to be cut down to Rs. 1,500, use his powers or exert special abilities to make Rs. 20,000 or a higher amount? If the accumulation of capital has any value in the social and economic progress of a nation, the principle of least sacrifice, carried to its logical conclusion, would ultimately make the nation poorer.

Moreover, it is not only the accumulation of capital which would be prevented, but private individuals would hesitate to take risks or to launch new enterprises. Thus inventions and improvements which are essential to the progress of society would be hindered.

Hence, supporters of this principle may reach very different practical conclusions according to the amount of weight assigned to these two aspects of the principle. One may like to diminish the inequality of incomes and may give greater weight to the distributional aspect of the principle. Another may wish to maintain the productive system in a certain form and may thus attach greater importance to the production aspect of the principle.

Moreover, the principle assumes the amount to be raised by taxation to be fixed. But the amount to be raised depends upon the activities of the Government.

[1] Lord Stamp, op. cit. p. 186.

Lord Stamp rightly observes that the application of least sacrifice in progressive taxation to rectify inequalities in distribution is partly illogical and considerably overemphasized, and if given pre-eminence is misleading and dangerous.[1]

Equilibrium Approach in Public Finance

The work of the great Italian economist, Antonio De Viti de Marco, is an attempt to study public finance from an equilibrium approach. His main thesis is that the phenomena of public finance represent an integral part of general economic phenomena.[2]

In Economics we study the activities of an individual directed towards the satisfaction of individual wants. The production of economic goods in a given quantity at a given time represents the general economic problem. In public finance, we study the activities of the State directed towards the satisfaction of collective wants through the production of public goods.

Starting from this analogy between the phenomena of economics and public finance, De Viti proceeds upon the assumption that just as an individual is dominated in his actions by the attempt to maximize the satisfaction derived from his economic activities, so the members of a State desire that 'public goods shall be produced according to the law of least cost—because the lower the cost, the smaller will be their tax burden.'[3]

It is upon this foundation that De Viti builds his pure theory of public finance. He transfers the theory of value to public finance. He investigates the conditions to which the productive activity of the State must be subjected in order that the choice of public services which are to be produced, the administration of their respective amounts, the distribution of the cost among the consumers, etc., may take place according to the principle of the theory of value.'[4] Such an approach to the science of public finance would result in the greatest satisfaction of collective needs with the least possible waste of the efforts and wealth of a community.

In this analysis of production and consumption of public goods, instead of the individual, the State is the active subject, and in place of individual wants we have collective wants.

This forms the framework of De Viti's approach to public finance. A closer examination of the theory of the fee and tax shows how an

[1] Lord Stamp, op. cit. p. 188.
[2] A. De Viti de Marco, *First Principles of Public Finance*, 1936, p. 52.
[3] Ibid. p. 35.
[4] Ibid. p. 36.

equilibrium approach forms the foundation of a pure theory of public finance.

'Special' and 'General' Public Services

The satisfaction of collective wants is the chief function of the State. Collective wants are satisfied through the production of public services which may be divided into two broad groups: (*i*) special public services and (*ii*) general public services. The criteria of division between special and general public services depend upon whether the supply of the service is 'technically divisible into saleable units' or not. Special public services must be capable of retail sale in any quantity and at any moment. General public services on account of their character are not capable of division into saleable units. This criterion gives rise to the phenomenon of the fee.

The theory of the fee has been discussed in detail elsewhere. There it has been pointed out that in the supply of these services an exchange relationship between the State and the individual is established. The State charges a 'public price' for a 'public service'. This price is called a fee.

No exchange relationship can be established for the supply of general public services, e.g. the defence of the country. For such services the State levies a tax. A tax is a compulsory contribution demanded by the State for the supply of general public services consumed by an individual.

The fundamental distinction between a fee and a tax arises from the fact that in the case of the fee it is possible to distribute the cost of the special public services among the consumers according to the actual consumption of the service; while in the case of the tax this is not possible as the consumption of general public services is an indeterminate amount. The problem of public finance is to distribute the cost of the indivisible benefits of general public services among the members of the community. It is here that Dr. Benham develops the concept of 'neutrality' to explain the distribution of tax burden.

Neutral System of Taxation—An Ideal System

'A neutral system of taxation and public expenditure', observes Dr. Benham, 'is one which translates into effect the voluntary judgments and preferences of the citizens, whatever they may be.' In such a system of taxation 'the difficulties of defining ends, of weighing them, of considering other effects are evaded by the simple process

of accepting whatever decisions the citizens themselves make.'[1] The way to discover what a neutral system of taxation would be is to consider what would happen if instead of the State performing certain services they were collectively performed by a group of men.

One can conceive of the existence of a group of men in a small area without a State. In this isolated society an individual will feel the need that his person and his goods should be defended against external attack or against the other members of his group. The community may provide an army or guards. Later on, to solve the disputes between him and other members, the community may provide law and order. The benefit from these services is indivisible. If we assume that each individual of such a community has equal income and tastes, each person, in these circumstances, might agree to contribute an equal amount towards the collective provision of such services provided that all his fellows did the same. Offenders who failed to pay the contribution would be penalized. The taxation in such a case would reflect the voluntary judgements and preferences of individuals and would be neutral. There would be no force as each member might deem it to his advantage to restrict his freedom of expenditure as all his fellows were doing the same.

But with the development of economic, ethical and political ties, the need will be felt for other services, e.g. road construction and maintenance, public instruction, the supply of water, etc. The benefits of these services are divisible. Suppose these services are sold by private entrepreneurs who charge from each consumer a price corresponding to the amount of the service consumed, e.g. providing roads and charging tolls. But the inconvenience of frequent stoppages would soon lead the people to think that it is better to have free roads and to meet the cost by taxation.

The coming of the State for providing these services 'will introduce no disturbing force. Each person will prefer the new situation to the old one. And it will be noted that all this involves no interpersonal comparison or addition of utilities, such as is sometimes implied in the concept of "collective wants". Each acts according to his own preference.'[2]

Now if we discard the conception of equal incomes and tastes, the new situation will make no difference in our analysis. Different persons will demand the collective wants in different amounts. But 'men with equal tastes', says Benham, 'may be prepared to pay

[1] Benham, F., 'Notes on the Pure Theory of Public Finance', *Economica*, November, 1934, p. 445. All page references are to this.

[2] Benham, op. cit. p. 452.

different amounts towards a collective service because their incomes are different. Similarly with men of equal incomes whose tastes, including those arising from their different locations or occupations, are different. For the amount of collective expenditure which a person desires will vary with the proportion of the total cost which he has to pay.'[1]

Dr. Benham makes the above statement on the presumption that all the members in the community consume collective services. This corresponds with reality. Everybody derives benefits from the State protection of life and property. Everybody shares in the indivisible benefits of general public services. Those who disclaim these benefits (and consequently refuse tax payments) are in De Viti de Marco's words, 'a pathological group against which the society must defend itself'.[2]

It is on the above lines that Dr. Benham develops his theory of neutrality in taxation. This theory assumes that the various preferences of citizens are 'correctly mirrored by their representatives in Parliament'. It is based on democratic Government. 'Periodical elections, constant criticism from the Press and organized groups, the habit of making concessions to minorities usually ensures that no substantial body of opinion is for long in sharp disagreement with the whole system of public finance which prevails.'[3]

The conclusions of this analysis are in no way vitiated by objections like: What about benefits to persons suffering from sickness, unemployment or old age? Men who are not able-bodied can be helped either by voluntary aid or by special State provision, e.g. the State might for the sake of society as a whole, and with general consent, (*i*) exempt from taxation incomes below a certain level, and (*ii*) assist from general taxation those whose incomes do not reach the minimum subsistence level. There is nothing in the concept of neutrality to exclude what Dr. Benham calls a 'social conscience'. Moreover, when the incomes and tastes of individuals differ, the

[1] Benham, op. cit. p. 453. To the above analysis it may be objected that as the consumption of general public services is not proportional to the income of each citizen, the principle of neutrality breaks down. A little reflection, however, will show that this is not the case. Since income is the best single measure of judging the ability of an individual to consume general public services, we may justify our presumption by saying that if group 1 demands and consumes twice as many public services as compared with group 2, it is merely because the income of group 1 is twice as much as that of group 2. It is quite likely that group 1 may not consume, at a given moment, services on objects, say A and B and group 2 on objects C and D. But in a long period of time, for example, a generation, difference of the total consumption of public services between groups 1 and 2 will diminish or disappear.

[2] De Viti, op. cit. p. 114.

[3] Benham, op. cit. p. 455.

State, as pointed out previously, can follow a policy of discrimination in charging different prices to different people for special public services.

Despite the fact that no completely neutral system of public finance exists or has ever existed, the conclusion cannot be avoided that this concept of neutral taxation is one of the most eloquent contributions to the pure theory of public finance.

The Best Tax Scheme

Having discussed the ideal tax system from a theoretical point of view, let us work out a tax scheme which may be best in practical application. The object of such a scheme should be to increase the prosperity of a nation. 'Prosperity', says Dr. Benham, 'is the state or condition of being more or less "well-off" in a strictly material sense.'[1] There are innumerable factors which influence the prosperity of a nation. Thus climatic conditions (especially rainfall in the case of India), natural resources, industrial and agricultural development, transport facilities, monetary and banking policy, the machinery of public finance, the system of government, education, health and a hundred other factors may influence the prosperity of a nation. A discussion of all these factors is beyond the scope of this work. Hence we shall try to show how the prosperity of a nation is influenced through the machinery of public finance.

The system of public finance can influence the prosperity of a nation essentially in two ways: (*i*) reducing inequality of incomes, and (*ii*) influencing the system of production. The mode in which the national income is distributed among the members of the community affects prosperity. It is often the case that while the total national income is great, the way in which it is shared out is not even. Thus a small percentage of the income-receiving population may take a large proportion. The general opinion of economists is that 'whilst some inequality is both desirable and inevitable, great inequality is a waste of material welfare.' Thus public finance can increase prosperity by altering the unevenness which usually prevails in the distribution of national income.

Public finance also affects the system of production in a country. It may injure future production. The tariff policy of a country may result in a diversion of labour and capital from more profitable employment to less profitable employment. A high rate of income-tax may lead to some diminution in the growth of capital. The tax system may encourage the growth of monopolies. On the other

[1] Benham, *The Prosperity of Australia*, 1930, p. 1.

hand, a well-operated system of public finance may increase the volume of production with the result that the increased size of national income may, on an average, give a larger share to each member of the community.

Thus the best system of taxation to increase the prosperity of a nation should increase its volume of production as well as secure a better distribution of national income. As stated previously, since taxation in practice represents practical compromise, no scheme of taxation can secure absolute scientific precision in the application of the above two principles. To every tax system objection can be raised; our object is to indicate a well-balanced system, coming nearest to the realization of the two principles, which is least objectionable and most effective.

Reducing Inequality of Incomes

The problem of reducing the inequality of incomes raises four questions: (*i*) Why should the State reduce the inequality of incomes? (*ii*) To what extent should the inequality be removed? (*iii*) In what way can the inequality be minimized? and (*iv*) What machinery should be employed to reduce inequality? We shall consider each of these questions in turn

'Taxation for revenue only' was a Victorian slogan of public finance. Taxation for objects other than revenue was considered impolitic or wrong. The common opinion was that it was no part of the duty of the State to 'readjust the vicissitudes of fortune'. But public opinion of late has changed, and taxation now is justified as an engine for redistribution of wealth. The reason for this, to use the words of Dr Benham, is that 'since prosperity is, ultimately, a state or condition, a given national income would "go further" if it were somewhat less unevenly distributed than is often the case in modern communities.'[1] Hence taxation in modern States is not always swayed by revenue considerations. The State, to increase the prosperity of the nation, aims at a more equitable distribution of wealth.

This change in attitude towards taxation is primarily due to the enlarged conception of equity. 'Equity', Professor Marshall says, 'as an adequate guide in the philosophy of taxation', was based on the principle of existing rights; 'it was generally considered equitable that everyone should contribute' on the joint-stock plan to the expenses of the State. So that, if taxation aimed at redistribution of wealth it was manifestly wrong and unjustifiable. This conception

[1] Benham, op. cit. p. 11.

changed later on and it was generally recognized, to quote Professor Marshall again, that 'though a joint-stock company must accept them (existing rights) as final, the State is under obligation to go behind them; to inquire which of them are based on convention or accident rather than fundamental moral principle; and to use its powers for promoting such economic and social adjustments as will make for the well-being of the people at large.'[1]

A National Minimum Income

This brings us to the second question. To what extent should the State reduce inequality of incomes? Here we are at once faced with a difficulty. On the question of what ought to be the functions of the State, people may differ. For this is a matter of opinion, and economic analysis cannot prove that one opinion is right and another wrong. A socialist may advocate complete equality of incomes to achieve a social millennium. But there is grave danger that drastic changes in the redistribution of income may check economic progress and may curtail the volume of production per head. Hence we think it desirable to state (to avoid these controversial matters) that within the framework of capitalism the State should try to achieve the ideal of providing every citizen with a national minimum real income.

Before stating how to achieve this, it is desirable to signify what precisely is meant by a national minimum standard of real income. 'It must be conceived,' says Professor Pigou, 'not as a subjective minimum of satisfaction, but as an objective minimum of conditions. The conditions, too, must be conditions, not in respect of one aspect of life only, but in general.'[2] The determinants of a national minimum income have been stated by Dr. Benham under four heads. Briefly they are:

(*i*) The provision of adequate food, clothing, medical attention, education and other essentials, for all children. (This would reduce the influence of environment and opportunity in causing the differences in earnings which explains, to some extent, the gulf between the 'haves' and the 'have-nots').

(*ii*) The removal of the haunting shadow of insecurity which darkens many lives.

(*iii*) The reduction of inequality of incomes through the machinery of public finance.

[1] Marshall, Alfred, *National Taxation after the War*. This forms chapter xviii in 'After War Problems', edited by William Harbutt Dawson, 1917, p. 317.

[2] Pigou, A. C., *The Economics of Welfare*, p. 714.

(*iv*) The improvement of productive capacity through greater public expenditure, chiefly upon health (and especially preventive measures) and education.[1]

The provision of a national minimum income, taking all the above factors together, could be achieved by transferences of national income from the relatively rich to the relatively poor. A detailed discussion of these heads is clearly beyond the scope of a work on provincial finance in India. However, we shall indicate the different types of transferences effected in a modern State.

These transferences can be grouped under two heads; first, those which increase the income of the citizen directly. The transference in the form of pensions, unemployment insurance, and poor relief, would come under this head. The tacit assumption underlying the State expenditure on education, health, medical, and similar services is based on the expectation that the poorer members of the community will derive greater benefit from these services than the rich. The transference of national income in the form of services in favour of the poor is a growing proportion of the national expenditure. But there is one difficulty here. In practice it is not possible to set up a standard which a person must satisfy before he is entitled to the benefit of these services. The result is that these services benefit equally different persons (rich and poor) whose circumstances are substantially different, Mrs. Hicks writes, for example: 'The extent to which the social services imply a redistribution of the national income from the richer to the poor part of the community naturally differs very much from one service to another, as it does from one country to another.[2] In ideal conditions a separate standard capacity would be fixed for different groups into which the community may be classified. Thus, persons having a certain income alone should be entitled to use, say, education and medical services provided out of national income. The redistributive character of the plan would depend upon the skill of the classifying authorities, and the co-operation between the Government and the governed.

The Case for a Single Tax

Having indicated the reasons, the extent and the methods by which the State attempts to reduce inequality of incomes, we now turn to the most important field of our inquiry, namely, what machinery should the State employ to reduce inequality of incomes? This is the most complicated matter. The State raises its revenue

[1] Benham, op. cit. pp. 240-1.

[2] Hicks, U. K., *The Finance of British Government*, 1920-36, Oxford University Press, 1938, p. 56.

in a great number of ways and for a great variety of reasons. Here we have to evolve a scheme which will increase national prosperity. We have to discuss the problems of the distribution of taxation.

Some writers cherished the idea of a single tax on land values. The Physiocrats advocated a single tax 'on the net product of the soil'. Their argument is that since the amount of land is limited and the increment in the value of land is due to the 'progress of the society', a tax on land-value justly belongs to the State and should pay all its expenses. The arguments against the single tax on land-values are too well known and need not be repeated. Today, little is heard of this proposal.

This idea of a single tax on land-values has been followed by proposals for a single tax on 'expenditure'; a single tax on 'capital'; a single tax on income, etc., etc. The most popular single tax discussed nowadays is the single tax on income. On this point I cannot do better than quote Dr. Benham's words: 'There is a much stronger theoretical case for a tax on income. For income is the best single measure of ability to pay, and if income alone were taxed, the Government would be able to decide exactly how much a man with a given income should pay. If it wished, it could exempt altogether incomes below a certain level, it could tax incomes from property more heavily than incomes from works, it could allow deduction for children, and so on.'[1]

If there were only an income-tax, a tax-payer, after paying the tax, would be at liberty to spend his income in whatever way he chose. As it is, taxation of commodities penalizes the consumers who happen to use the taxed commodities as compared with those who do not. Thus the taxation of salt and sugar hits the income of a poorer man much more than that of a rich man. Such taxation cannot be 'progressive'; it is not even 'proportional' to the total incomes of the two; it is not even 'proportional' to the amount spent by each over these objects. But as a man earning, say Rs. 50, buys much more of the taxed commodities than the rich man, the former pays much more in taxation though he pays nothing in income-tax. A single tax on income would be free from all these defects.

Perhaps the greatest limitation to the proposal for a single tax on income is that it is not possible to ascertain the total income of every citizen. As Professor De Viti says: 'If a synthetic method were available for the ascertainment of the total income of every citizen with uniform results, the single tax would solve the problem of simplification. But the concrete problem resides precisely in making

[1] Benham, op. cit. p. 305.

the hypothesis a reality.'[1] Moreover, if the income-tax were increased and the other taxes abolished, the burden upon the tax-payers may appear to be too heavy and may result in fraud and evasion. Income-tax, in Gladstone's words, was bad because it made a 'nation of liars'. Hence, a single tax on income, though theoretically sound, is on the grounds of workability exposed to dangers. In this connection the observation of Lord Stamp may be quoted with profit: 'It may be taken as axiomatic that the more closely the tax conforms to just principles the more open it will be to evasion, and the problem for the State is always how closely to conform to principle without giving up its safeguards.'[2]

From this we may conclude in order that no incomes escape taxation and the tax scheme be practicable, the single tax on income must be supplemented by other taxes. This is done in most modern States through a system of manifold taxes, which consists in the transformation of a single tax into various taxes. The system differentiates income into several sub-categories—as, for example, 'income spent' or 'income saved'; or again, income from land, from capital, from trade and industry, from professions. For each type of income a different rate may be fixed; the object being to increase or decrease the tax burden on some classes of income as compared with others.

A Manifold Tax System

Differentiation is usually achieved by dividing the tax system into direct and indirect taxes. The criteria for distinguishing between these two types of taxes have given rise to much controversy, but need not detain us here. Each basis of distinction is open to some criticism. Thus John Stuart Mill's definition, to take only one example, of a direct tax as one 'demanded from the very persons who, it is intended, or desired, should pay it', and an indirect tax as one 'demanded from one person in the expectation and intention that he shall indemnify himself at the expense of another', does not always square with actual facts.[3]

Perhaps the best way to get out of these difficulties is to look at the division from the point of view of practical administration, which has reference to the method of collection. According to this criterion a direct tax is one which is levied at fixed intervals from persons whose names are known to the tax authorities. Indirect taxes are levied on the occasion of certain definite acts, which do not fall at fixed intervals and do not require the lists of names

[1] De Viti, op. cit. p. 206.
[2] Stamp, op. cit. p. 119.
[3] Mill, *Principles of Political Economy*, p. 423.

of tax-payers. An elaboration of this discussion is not relevant to our subject.

The main object of the introduction of direct and indirect taxes is to divide the tax-payer's fiscal obligation into several parts; part of which he must pay by direct taxes and part by indirect taxes. It is easy to show how a tax system, where both direct and indirect taxes exist side by side, is superior to one where only one of them exists. The outstanding problem is the distribution of the burden in reality on some principles. From what has been said before, it follows that the most important principle is to tax according to ability to pay. Indisputable as this principle is, in its practical application many difficult issues confront us. In measuring ability to pay we not only take certain objective attributes as indicia but also something which relates solely to the subjective side of human life. For example, the exemption of the minimum income from taxation is based on humanitarian as well as economic grounds. The really important question, therefore, before us is what tests should be applied to measure ability and what relative importance should be attached to each of them. Four such tests of ability readily occur to one. They are:

(*i*) Net income
(*ii*) Net assets
(*iii*) Expenditure
(*iv*) Special ability.

We shall discuss each of these, one by one.

Tests of 'Ability' to pay: (i) 'Income' as a Test of Ability

It has been shown that income is the best single test of ability to pay. But as income sometimes depends on the assets of an individual, assets may be taken as the second test of ability.

Income is always measured over a period of time; a week, a month, or a year. It may arise from the labour of the worker himself (e.g. wages, salaries, fees); it may be due to the assets of the person (e.g. interest, rents, dividends); or lastly, it may arise as a result of State policy (e.g. pensions or unemployment allowances). Thus, an individual may receive income from either of the first two sources or both of them. Income arising from the third source is merely a redistribution of a portion of the national income raised through taxation among certain sections of the community.

Income as a test of ability may be taken to mean the net receipts of an individual from all sources during a given period of time. Thus the business expenses of a manufacturer, or the cost of main-

taining property, or other expenses to maintain capital intact, should be deducted before finding the net receipts available for taxation. Similarly, it is commonly recognized that to maintain human capital intact, a certain minimum expenditure on food, clothing, housing and other necessaries for efficiency should be exempted from taxation. In fact the income-tax law of practically every country exempts a certain minimum income from taxation.

It is important to remember, however, that before ability can be properly tested by net income, the time factor should be taken into account. 'We are so used to considering income "by the year" that it seems to be almost an ordinance of nature.'[1] Yet income fluctuates from year to year. A tax system that does not take into consideration a proper unit of time for a particular type of income is bound to be inequitable. To take one example: the British income-tax differentiates against industries whose profits fluctuate over time as compared with those that are stable. This will appear from the following table:

Year	Income of Firm I	Surtax	Income of Firm II	Surtax
1 ..	£2,000	0	£10,000	£1,519- 7 -6
2 ..	£3,000	£61-17-6	,,	,,
3 ..	£25,000	£6,469- 7 -6	,,	,,
4 ..	£4,000	£171-17-6	,,	,,
5 ..	£16,000	£3,361-17-6	,,	,,
	£50,000	£10,065- 0 -0	£50,000	£7,596-17-6

It is clear from the table that firm I, whose income fluctuates from year to year, pays more in surtax than firm II during a period of five years.

It is not possible to suggest a definite period of time which may be suitable for all types of incomes. However, a three or five years' average system would give power to an individual to carry over his income. In an agricultural country, where agricultural conditions fluctuate from year to year, a five years' period would perhaps be suitable.

(ii) *Assets as a Test of Ability*

The assets of an individual at a certain point of time represent the market value of all his possessions, plus the value of the debts receivable by him and minus the value of the debts payable from him. The assets of an individual may be in various forms; they may range from stocks and shares, land and buildings and hoarded money, to jewellery, ornaments and furniture.

The assets of an individual are of less importance than his income

as a test of ability. In the first place, a part of his assets cannot be taxed. A person who locks up Rs. 10,000 in diamonds escapes the payment of tax on that amount during his lifetime. Thus assets of the type of hoarded money (a common type in India), jewellery, ornaments, furniture or other non-income-yielding assets are outside the pale of taxation during a certain period of time. In the second place, the appraisal of the revenue-yield from assets is a matter of difficulty. No doubt in some cases, either through fraud or understatement, it escapes detection. Moreover, reappraisals of incomes from certain types of assets cannot be made as rapidly as the times vary. Thus, while the tax on land or buildings is fixed for long periods the incomes vary meanwhile.

Nevertheless, assets are a useful test of ability on certain occasions. They give rise to the distinction between 'earned' and 'unearned' income. The reasons for giving favoured treatment to earned income depend upon the fact that its continuance depends upon the effort of the particular person. It stops when he ceases to work. Such a person has to make various personal and domestic allowances. The possession of capital thus affects 'ability to pay' in incomes. Taxes on capital transactions and transfers of property (in the shape of stamp duties) represent indirect taxes on savings and are justified on the score of assets as a test of ability. Finally, assets are a useful test of ability in death duties.

(iii) Expenditure as a Test of Ability

The first two tests of ability—net income and net assets—present few difficulties. Expenditure as a test of ability, in capitalistic countries with sharp inequalities in income and assets, creates differentiation in taxation. In the search for the exemption of savings from taxation, Professor Pigou considers the possibility of a general expenditure tax. 'If that part of income,' says he, 'which is devoted to the purchase of consumable goods and service, as distinct from capital goods and services, is taxed, and the rest left untaxed, we shall obviously have a tax system under which "spent" income is taxed and "saved" income exempted.'[1] Logically, an expenditure tax would exempt savings from taxation. Apart from the considerations whether the exemption of savings is desirable or not (to them we return in another section), the practical difficulties in the successful working of the tax rule it out of court. We have, therefore, to inquire whether it is desirable to have expenditure as a subsidiary test of ability without causing too much tax differentiation.

[1] Pigou, op. cit. p. 141.

It is universally recognized that every individual, to realize that he is a citizen, must pay some tax towards the cost of the State. Direct taxation of the income of the poorer classes, even roughly to conform to the principle of ability, is difficult and troublesome. Its assessment and collection will need an army of collectors and may leave a wide-open door for evasion and fraud. The administrative costs may ultimately be higher than receipts. Hence a tax on expenditure in the shape of indirect taxes is levied. Excise duties and customs are the most common examples of indirect taxes.

In addition to the administrative difficulties another reason for the levy of taxes on commodities is the practical one of plucking the goose with the least *squealing*. The tax is wrapped up in the price of a commodity and hence causes much less resentment among the tax-payers than would be caused by an equal amount raised through direct taxation.

Theoretically, it would be ideal to have a progressive expenditure tax; in it 'it would be necessary to impose upon each commodity, not a single rate, but a number of different rates adjusted to the incomes of the various purchasers.'[1] Such an arrangement, however, is practically impossible. Hence we have *ad valorem* or specific duties. Here difficulties arise. *Ad valorem* commodity taxes, though proportionate, are actually regressive; the ratio of the tax is different to different incomes. Thus, if everybody's expenses on certain taxed articles were the same, irrespective of the size of their incomes, the rates of the taxes borne by them would vary inversely to the size of their incomes; for example, if the tax is 1 pice in the rupee for an income of Rs. 1,000; it would be 2 pice in the rupee for an income of Rs. 500; 1 anna in the rupee for an income of Rs. 250; and 2 annas in the rupee for an income of Rs. 125.

There are, however, more serious objections than this. Experience shows that the poor, as a class, by reason of family obligations, consume a larger quantity of lucrative revenue-yielders, i.e. necessaries of life than the rich, and, therefore, pay not only a higher rate of tax, but also absolutely more. Moreover, as most taxes in practice are specific, the poor pay more by consuming articles of an inferior quality.

There are many other defects of expenditure as a test of ability. Some might object to it as it does not take into account what Lord Stamp calls the 'domestic circumstances' of the tax-payer; others might say that it fails to do justice as it does not discriminate between earned and unearned incomes; still others might contend that as

[1] Pigou, op. cit. p. 142.

it does not tax net assets it is leaving out an important test of ability. But few would deny that as a supplementary test of ability some weight should be given to it. It is a minor test of ability. In practice, unfortunately, those who direct public affairs, through ignorance, party politics, national pride or vested interests, attach undue importance to expenditure taxes. Other considerations outweigh economic reasons. The result is that the tax system of the country becomes regressive instead of progressive. This ultimately must react on the prosperity of the nation. In such a case, the most obvious remedy is to arouse the electorate to demand from the statesmen the course of policy which will serve their interests best.

(iv) Special Ability

Net income, net assets and expenditure as tests of ability should be supplemented by special ability. Special ability should be applied in relation to the taxation of windfalls. By 'windfalls' Professor Pigou means 'accretions to the real value of peoples' property that are not foreseen by them and are not in any degree due to efforts made, intelligence exercised, risks borne, or capital invested by them.'[1] The special ability principle may be applied in the case of both income and assets. Thus irregular or spasmodic receipts do not require the same sacrifice or efforts as does regular income, and possess a higher degree of ability. The taxation of the increment in land-values due to the progress of society, or the excess profits earned during wartime, or windfalls due to lotteries, fall under the special ability principle. Similarly, the taxation of big inheritances may also be looked at from this point of view.

As under the principle only extraordinary gains in income or capital would come under taxation, the principle as a test of ability is of minor importance. Nevertheless, it is peculiarly suitable for application on certain occasions.

The Tax System must be Progressive

Finally, progression must form the most prominent feature in the tax system of every country. The reduction of inequality of incomes is attempted through progression. Whether it is the taxation of income or assets, progression is universally applied. It is also of help in the application of the special ability principle. A rough approximation to progression is attempted in expenditure-taxes by taxing articles mainly consumed by the rich at higher rates than those consumed by the poor. We have placed progression last, not

[1] Pigou, op. cit. p. 177.

because it is of least importance, but because it is the universal principle which should be applied in all the tests of ability. The arguments for this have been discussed in pages 304-6.

Income-Tax and Savings

Into the wider question how taxation affects the productive system in a country, is not possible to enter here. As income forms the principal test of ability in the tax scheme described above, I shall briefly consider the disputed question whether an income-tax discriminates against savings or not.

There is no unanimity of opinion among economists on this point. Professor Pigou is of the opinion that a permanent general income-tax discriminates against savings. Professor Cannan, Dr. Benham, Professor De Viti and Lord Stamp put forward the contrary view. Let us state briefly the main arguments of each view.

Professor Pigou contrasts the effects of a permanent expenditure-tax (i.e. a tax on consumed income) with a permanent general income-tax. He says: 'Under the former, resources that are saved are taxed indirectly, through their subsequent yield, to the same extent as resources that are consumed at once. There is, therefore, no differentiation of any kind. An income-tax, on the other hand, differentiates against saving, by striking savings both when they are made and also when they yield their fruits. Thus a general permanent income-tax at the rate of x per cent strikes the part of income that is spent at this rate. But, if £100 of income is put away from saving, it removes £x from it at the moment and, thereafter, removes also some part of the fruits yielded by it.'[1] The opposite view has been plainly put by Lord Stamp. 'Let us assume that a man saves £100 and at the end of ten years has had £5 per annum, and still having his £100 he then spends it. He pays tax in all upon £150 either under the present system, when his tax is on the £100 at first and the £50 by annual instalments afterwards, or under an alternative system of taxation on expenditure, where he pays on £5 per year for ten years and £100 in the tenth.'[2]

Professor Pigou is mistaken in his view in assuming that savings are never withdrawn for spending. For, as Dr. Benham has pointed out, 'it can be urged that in order to make a complete comparison between the two taxes in question, we must consider the whole cycle—accumulation of capital, receipt and expenditure of interest,

[1] *See* Pigou, op. cit. p. 136; Benham, *Economica*, November, 1934; Stamp. op. cit. pp. 58-61. See also *Economic Journal*, 1935, (Sept.), Guillebaud's article on 'Income Tax'.

[2] Stamp, op. cit. p. 60.

and withdrawal and expenditure of capital. It then seems that if an income-tax can be said to strike savings twice, so can a general expenditure-tax. The former strikes them when they are made, and when interest on them is received, but not when they are withdrawn and spent. The latter does not strike them when they are made, but it does strike them both when interest on them is spent and when the savings are withdrawn and spent.'[1]

The issue, perhaps, can be clarified by means of an arithmetical example. With 5 per cent rate of interest, £100 saved will become £105 in a year. If there is no income-tax this will remain £105. If income-tax is 20 per cent, £100 saved will become only £104. Now suppose there is a sales tax of 20 per cent, £100 spent now are worth £80. £105 spent at the end of a year are worth £84.[2] Thus the terms of exchange are unaltered whether there is an income-tax or sales tax, for 80 : 84 : : 100 : 105. Hence an income-tax on savings does not discriminate against savings.

Conclusion

Our brief survey of the broad characteristics of the scheme has demonstrated the possible ways in which the tax burden of a country may be distributed. But the practical difficulty remains. Various sets of weights may be assigned to each test. One set of weights may yield quite a different result from another. Moreover, the set of weights would differ between times and places. For each country various compromises may be possible. Clearly the differences in results in each compromise would reflect the effect of the weights assigned to each test. As time goes on the weights may have to be changed. For example, the real income of the population or the character of its distribution among the people may change. People may spend a larger proportion of their incomes on objects which formerly used to be considered as luxuries, e.g. motor cars, radios, expensive dresses, and so on. The sharp inequalities in income and property may change. This may give commodity taxes scope to play a dominant part; for taxes on expenditure are less regressive when objects of taxation are luxuries or where a considerable majority of the members in a community are almost equally wealthy. In time of war, when businessmen are making enormous windfall profits, the special ability test should be assigned a greater weight. The industrial revolution increased the total volume of production in England but created a wider gulf between 'haves' and 'have-

[1] Benham, op. cit. p. 442.

[2] It is assumed here that savings are withdrawn for spending and a tax is paid on them.

nots'. The necessity for a heavier weight to net income was clearly visible in those days. One conclusion which emerges from all this is that the practical application of the tests will differ between times and places; and the tax system, though largely dependent upon the tests indicated above, will be to some extent arbitrary.

Nevertheless, it may be stated that, to make the tax system of a country progressive, greater weight ought to be attached to direct taxation of net income and net assets appears to be the most desirable lines of action. Thus income-tax, corporation tax, super-tax and death duties should be, among others, the most important sources of revenue for the State. To tax the incomes of the poor classes so that everybody should contribute something towards the expenses of the State, indirect taxes should be imposed. Taxation of a few necessaries of life, through customs or excises, should form an important feature of the tax system. In selecting the necessaries of life it must always be kept in mind that unnecessary hardship should not be inflicted on the poorer classes. Taxation of luxuries should also be made to contribute a substantial portion of the State revenues.

In practice, to evolve a tax system free from all possible defects is an almost impossible task. For one thing taxation is a matter of expediency. For another no finance minister can suddenly break through the established tax-system. Finally, it would be difficult to estimate exactly the incidence of each tax. Hence the aim of the finance minister should be to make the system progressive. The justice or injustice of the tax system lies essentially in whether it is progressive or regressive.

APPENDIX II

LEGISLATIVE LISTS

(Article 246)

List I—Union List

1. Defence of India and every part thereof including preparation for defence and all such acts as may be conductive in times of war to its prosecution and after its termination to effective demobilisation.

2. Naval, military and air forces; any other armed forces of the Union.

[1]3. Delimitation of cantonment areas, local self-government in such areas, the constitution and powers within such areas of cantonment authorities and the regulation of house accommodation (including the control of rents) in such areas.

4. Naval, military and air force works.

5. Arms, firearms, ammunition and explosives.

6. Atomic energy and mineral resources necessary for its production.

7. Industries declared by Parliament by law to be necessary for the purpose of defence or for the prosecution of war.

[2]8. Central Bureau of Intelligence and Investigation.

[2]9. Preventive detention for reasons connected with Defence, Foreign Affairs, or the security of India; persons subjected to such detention.

10. Foreign Affairs; all matters which bring the Union into relation with any foreign country.

11. Diplomatic, consular and trade representation.

12. United Nations Organisation.

13. Participation in international conferences, associations and other bodies and implementing of decisions made thereat.

14. Entering into treaties and agreements with foreign countries and implementing of treaties, agreements and conventions with foreign countries.

15. War and peace.

16. Foreign jurisdiction.

17. Citizenship, naturalisation and aliens.

[1] In its application to the State of Jammu and Kashmir, the following shall be substituted for entry 3:

'3 Administration of cantonments.'

[2] These items are not applicable to the State of Jammu and Kashmir.

18. Extradition.

19. Admission into, and emigration and expulsion from, India; passports and visas.

20. Pilgrimages to places outside India.

21. Piracies and crimes committed on the high seas or in the air; offences against the law of nations committed on land or the high seas or in the air.

22. Railways.

23. Highways declared by or under law made by Parliament to be national highways

24. Shipping and navigation on inland waterways, declared by Parliament by law to be national waterways, as regards mechanically propelled vessels; the rule of the road on such waterways.

25. Maritime shipping and navigation, including shipping and navigation on tidal waters; provision of education and training for the mercantile marine and regulation of such education and training provided by States and other agencies.

26. Lighthouses, including lightships, beacons and other provision for the safety of shipping and aircraft.

27. Ports declared by or under law made by Parliament or existing law to be major ports, including their delimitation and the constitution and powers of port authorities therein.

28. Port quarantine, including hospitals connected therewith; seamen's and marine hospitals.

29. Airways; aircraft and air navigation; provision of aerodromes; regulation and organisation of air traffic and of aerodromes; provision for aeronautical education and training and regulation of such education and training provided by States and other agencies.

30. Carriage of passengers and goods by railway, sea or air, or by national waterways in mechanically propelled vessels.

31. Posts and telegraphs; telephones, wireless, broadcasting and other like forms of communication.

32. Property of the Union and the revenue therefrom but as regards property situated in a State[1]*** subject to legislation by the State, save in so far as Parliament by law otherwise provides.

[2]* * * * *

[3]34. Courts of wards for the estates of Rulers of Indian States.

35. Public debt of the Union.

36. Currency, coinage and legal tender; foreign exchange.

[1] The words and letters 'specified in Part A or Part B of the First Schedule' omitted by the Constitution (Seventh Amendment) Act, 1956, s. 29 and Sch.

[2] Entry 33 omitted by s. 26, ibid.

[3] Not applicable to the State of Jammu and Kashmir.

37. Foreign loans.

38. Reserve Bank of India.

39. Post Office Savings Bank.

40. Lotteries organised by the Government of India or the Government of a State.

41. Trade and commerce with foreign countries; import and export across customs frontiers; definition of customs frontiers.

42. Inter-State trade and commerce.

[1]43. Incorporation, regulation and winding up of trading corporations, including banking, insurance and financial corporations but not including co-operative societies.

[2]44. Incorporation, regulation and winding up of corporations, whether trading or not, with objects not confined to one State, but not including universities.

45. Banking.

46. Bills of exchange, cheques, promissory notes and other like instruments.

47. Insurance.

48. Stock exchanges and future markets.

49. Patents, inventions and designs; copyright; trademarks and merchandise marks.

[2]50. Establishment of standards of weights and measures.

51. Establishment of standards of quality for goods to be exported out of India or transported from one State to another.

[2]52. Industries, the control of which by the Union is declared by Parliament by law to be expedient in the public interest.

53. Regulation and development of oilfields and mineral oil resources; petroleum and petroleum products; other liquids and substances declared by Parliament by law to be dangerously inflammable.

54. Regulation of mines and mineral development to the extent to which such regulation and development under the control of the Union is declared by Parliament by law to be expedient in the public interest.

[2]55. Regulation of labour and safety in mines and oilfields.

56. Regulation and development of inter-State rivers and river valleys to the extent to which such regulation and development under the control of the Union is declared by Parliament by law to be expedient in the public interest.

57. Fishing and fisheries beyond territorial waters.

[1] In its application to the State of Jammu and Kashmir, the words 'trading corporations, including' in item 43 shall be omitted.

[2] Not applicable to the State of Jammu and Kashmir.

58. Manufacture, supply and distribution of salt by Union agencies; regulation and control of manufacture, supply and distribution of salt by other agencies.

59. Cultivation, manufacture, and sale for export, of opium.

[2]60. Sanctioning of cinematograph films for exhibition.

61. Industrial disputes concerning Union employees.

62. The institutions known at the commencement of this Constitution as the National Library, the Indian Museum, the Imperial War Museum, the Victoria Memorial and the Indian War Memorial, and any other like institution financed by the Government of India wholly or in part and declared by Parliament by law to be an institution of national importance.

63. The institutions known at the commencement of this Constitution as the Benares Hindu University, the Aligarh Muslim University and the Delhi University, and any other institution declared by Parliament by law to be an institution of national importance.

64. Institutions for scientific or technical education financed by the Government of India wholly or in part and declared by Parliament by law to be institutions of national importance.

65. Union agencies and institutions for:

(*a*) professional, vocational or technical training, including the training of police officers; or

(*b*) the promotion of special studies or research; or

(*c*) scientific or technical assistance in the investigation or detection of crime.

66. Co-ordination and determination of standards in institutions for higher education or research and scientific and technical institutions.

[1]67. Ancient and historical monuments and records, and archaeological sites and remains, [2](declared by or under law made by Parliament) to be of national importance.

68. The Survey of India, the Geological, Botanical, Zoological and Anthropological Surveys of India; Meteorological organisations.

[3]69. Census.

70. Union public services; all-India services; Union Public Service Commission.

[1] In its application to the State of Jammu and Kashmir, for entry 67, the following shall be substituted:

'67. Ancient and historical monuments, and archaeological sites and remains, declared by Parliament by law to be of national importance.'

[2] Subs. by the Constitution (Seventh Amendment) Act, 1956, s. 27, for 'declared by Parliament by law.'

[3] Not applicable to the State of Jammu and Kashmir.

71. Union pensions, that is to say, pensions payable by the Government of India or out of the Consolidated Fund of India

[1]72. Elections to Parliament, to the Legislatures of States and to the offices of President and Vice-President; the Election Commission.

73. Salaries and allowances of members of Parliament, the Chairman and Deputy Chairman of Council of States and the Speaker and Deputy Speaker of the House of the People.

74. Powers, privileges and immunities of each House of Parliament and of the members and the committees of each House; enforcement of attendance of persons for giving evidence or producing documents before committees of Parliament or commissions appointed by Parliament.

75. Emoluments, allowances, privileges, and rights in respect of leave of absence, of the President and Governors; salaries and allowances of the Ministers for the Union; the salaries, allowances, and rights in respect of leave of absence and other conditions of service of the Comptroller and Auditor-General.

[2]76. Audit of the accounts of the Union and of the States.

77. Constitution, organisation, jurisdiction and powers of the Supreme Court (including contempt of such Court), and the fees taken therein; persons entitled to practise before the Supreme Court.

[3]78. Constitution and organisation of the High Courts except provisions as to officers and servants of High Courts; persons entitled to practise before the High Courts.

[4]79. [2]Extension of the jurisdiction of a High Court to, and exclusion of the jurisdiction of a High Court from, any Union Territory)

80. Extension of the powers and jurisdiction of members of a police force belonging to any State to any area outside that State, but not so as to enable the police of one State to exercise powers and jurisdiction in any area outside that State without the consent of the Government of the State in which such area is situated; extension of the powers and jurisdiction of members of a police force belonging to any State to railway areas outside that State.

[5]81. Inter-State migration; inter-State quarantine.

[1] In its application to the State of Jammu and Kashmir, reference to States shall not be construed as reference to that State.

[2] In its application to the State of Jammu and Kashmir, reference to States shall not be construed as reference to that State.

[3] Not applicable to the State of Jammu and Kashmir.

[4] Subs. by the Constitution (Seventh Amendment) Act, 1956, s. 29 and Sch.

[5] In its application to the State of Jammu and Kashmir, in item 81, the words 'inter-State quarantine' shall be omitted.

82. Taxes on income other than agricultural income.

83. Duties of customs including export duties.

84. Duties of excise on tobacco and other goods manufactured or produced in India except:

(*a*) alcoholic liquors for human consumption;

(*b*) opium, Indian hemp and other narcotic drugs and narcotics,

but including medical and toilet preparations containing alcohol or any substance included in sub-paragraph (*b*) of this entry.

85. Corporation tax.

86. Taxes on the capital value of the assets, exclusive of agricultural land, of individuals and companies; taxes on the capital of companies.

87. Estate duty in respect of property other than agricultural land.

88. Duties in respect of succession to property other than agricultural land.

89. Terminal taxes on goods or passengers, carried by railway, sea or air; taxes on railway fares and freights.

90. Taxes other than stamp duties on transactions in stock exchanges and future markets.

91. Rates of stamp duty in respect in bills of exchange cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts.

92. Taxes on the sale or purchase of newspapers and on advertisements published therein.

[1](92A. Taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce.)

93. Offences against laws with respect to any of the matters in this List.

94. Inquiries, surveys and statistics for the purpose of any of the matters in this List.

95. Jurisdiction and powers of all courts, except the Supreme Court, with respect to any of the matters in this List; admiralty jurisdiction.

96. Fees in respect of any of the matters in this List, but not including fees taken in any court.

[2]97. Any other matter not enumerated in List II or List III including any tax not mentioned in either of those Lists.

[1] Ins. by the Constitution (Sixth Amendment) Act, 1956, s. 2.

[2] Not applicable to the State of Jammu and Kashmir.

List II—State List

1. Public order (but not including the use of naval, military or air forces or any other armed forces of the Union in aid of the civil power).

2. Police, including railway and village police.

3. Administration of justice; constitution and organisation of all courts, except the Supreme Court and the High Court; officers and servants of the High Court; procedure in rent and revenue courts; fees taken in all courts except the Supreme Court.

4. Prisons, reformatories, Borstal institutions and other institutions of a like nature, and persons detained therein; arrangements with other States for the use of prisons and other institutions.

5. Local government, that is to say, the constitution and powers of municipal corporations, improvement trusts, district boards, mining settlement authorities and other local authorities for the purpose of local self-government or village administration.

6. Public health and sanitation; hospitals and dispensaries.

7. Pilgrimages, other than pilgrimages to places outside India.

8. Intoxicating liquors, that is to say, the production, manufacture, possession, transport, purchase and sale of intoxicating liquors.

9. Relief of the disabled and unemployable.

10. Burials and burial grounds; cremations and cremation grounds.

11. Education including universities, subject to the provisions of entries 63, 64, 65 and 66 of List I and entry 25 of List III.

12. Libraries, museums and other similar institutions controlled or financed by the State; ancient and historical monuments and records other than those [1](declared by or under law made by Parliament) to be of national importance.

13. Communications, that is to say, roads, bridges, ferries, and other means of communication not specified in List I; municipal tramways; ropeways; inland waterways and traffic thereon subject to the provisions of List I and List III with regard to such waterways; vehicles other than mechanically propelled vehicles.

14. Agriculture, including agricultural education and research, protection against pests and prevention of plant diseases.

15. Preservation, protection and improvement of stock and prevention of animal diseases; veterinary training and practice.

16. Pounds and the prevention of cattle trespass.

17. Water, that is to say, water supplies, irrigation and canals,

[1] Subs. by the Constitution (Seventh Amendment) Act, 1956, s. 27, for 'declared by Parliament by law.'

drainage and embankments, water storage and water power subject to the provisions of entry 56 of List I.

18. Land, that is to say, rights in or over land, land tenures including the relation of landlord and tenant, and the collection of rents; transfer and alienation of agricultural land; land improvement and agricultural loans; colonization.

19. Forests.

20. Protection of wild animals and birds.

21. Fisheries.

22. Courts of wards subject to the provisions of entry 34 of List I; encumbered and attached estates.

23. Regulation of mines and mineral development subject to the provisions of List I with respect to regulation and development under the control of the Union.

24. Industries subject to the provisions of [1](entries 7 and 52) of List I.

25. Gas and gas-works.

26. Trade and commerce within the State subject to the provisions of entry 33 of List III.

27. Production, supply and distribution of goods subject to the provisions of entry 33 of List III.

28. Markets and fairs.

29. Weights and measures except establishment of standards.

30. Money-lending and money-lenders; relief of agricultural indebtedness.

31. Inns and innkeepers.

32. Incorporation, regulation and winding up of corporations, other than those specified in List I, and universities; unincorporated trading, literary, scientific, religious and other societies and associations; co-operative societies.

33. Theatres and dramatic performances; cinemas subject to the provisions of entry 60 of List I; sports, entertainments and amusements

34. Betting and gambling.

35. Works, lands and buildings vested in or in the possession of the State.

[2] * * * * *

37. Elections to the Legislature of the State subject to the provisions of any law made by Parliament.

38. Salaries and allowances of members of the Legislature of the

[1] Subs. by the Constitution (Seventh Amendment) Act, 1956, s. 28, for 'entry 52'.

[2] Entry 36 omitted by the Constitution (Seventh Amendment) Act, 1956, s. 26.

State, of the Speaker and Deputy Speaker of the Legislative Assembly and, if there is a Legislative Council, of the Chairman and Deputy Chairman thereof.

39. Powers, privileges and immunities of the Legislative Assembly and of the members and the committees thereof, and if there is a Legislative Council, of that Council and of the members and the committees thereof; enforcement of attendance of persons for giving evidence or producing documents before committees of the Legislature of the State.

40. Salaries and allowances of Ministers for the State.

41. State public services; State Public Service Commission.

42. State pensions, that is to say, pensions payable by the State or out of the Consolidated Fund of the State.

43. Public debt of the State.

44. Treasure trove.

45. Land revenue, including the assessment and collection of revenue, the maintenance of land records, survey for revenue purposes and records of rights, and alienation of revenues.

46. Taxes on agricultural income.

47. Duties in respect of succession to agricultural land.

48. Estate duty in respect of agricultural land.

49. Taxes on lands and buildings.

50. Taxes on mineral rights subject to any limitations imposed by Parliament by law relating to mineral development.

51. Duties of excise on the following goods manufactured or produced in the State and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India:

(*a*) alcoholic liquors for human consumption;

(*b*) opium, Indian hemp and other narcotic drugs and narcotics,

but not including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (*b*) of this entry.

52. Taxes on the entry of goods into a local area for consumption, use or sale therein.

53. Taxes on the consumption or sale of electricity.

[1]54. (Taxes on the sale or purchase of goods other than newspapers, subject to the provisions of entry 92A of List I).

55. Taxes on advertisements other than advertisements published in the newspapers.

[1] Subs. by the Constitution (Sixth Amendment) Act, 1956, s. 2, for the original entry 54.

56. Taxes on goods and passengers carried by road or on inland waterways.

57. Taxes on vehicles, whether mechanically propelled or not, suitable for use on roads, including tramcars subject to the provisions of entry 35 of List III.

58. Taxes on animals and boats.

59. Tolls.

60. Taxes on professions, trades, callings and employments.

61. Capitation taxes.

62. Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling.

63. Rates of Stamp duty in respect of documents other than those specified in the provisions of List I with regard to rates of stamp duty.

64. Offences against laws with respect to any of the matters in this List.

65. Jurisdiction and powers of all courts, except the Supreme Court, with respect to any of the matters in this List.

66. Fees in respect of any of the matters in this List but not including fees taken in any court.

List III—Concurrent List [1]

1. Criminal law, including all matters included in the Indian Penal Code at the commencement of this Constitution but excluding offences against laws with respect to any of the matters specified in List I or List II and excluding the use of naval, military or air forces or any other armed forces of the Union in aid of the civil power.

2. Criminal procedure, including all matters included in the Code of Criminal Procedure at the commencement of this Constitution.

3. Preventive detention for reasons connected with the security of a State, the maintenance of public order, or the maintenance of supplies and services essential to the community; persons subjected to such detention.

4. Removal from one State to another State of prisoners, accused persons and persons subjected to preventive detention for reasons specified in entry 3 of this List.

5. Marriage and divorce, infants and minors; adoption; wills, intestacy and succession; joint family and partition; all matters in respect of which parties in judicial proceedings were immediately before the commencement of this Constitution subject to their personal law.

6. Transfer of property other than agricultural land; registration of deeds and documents.

[1] Not applicable to the State of Jammu and Kashmir.

7. Contracts, including partnership, agency, contracts of carriage, and other special forms of contracts, but not including contracts relating to agricultural land.

8. Actionable wrongs.

9. Bankruptcy and insolvency.

10. Trust and Trustees.

11. Administrators-general and official trustees.

12. Evidence and oaths; recognition of laws, public acts and records, and judicial proceedings.

13. Civil procedure, including all matters included in the Code of Civil Procedure at the commencement of this Constitution, limitation and arbitration.

14. Contempt of court, but not including contempt of the Supreme Court.

15. Vagrancy; nomadic and migratory tribes.

16. Lunacy and mental deficiency, including places for the reception or treatment of lunatics and mental deficients.

17. Prevention of cruelty to animals.

18. Adulteration of foodstuffs and other goods.

19. Drugs and poisons, subject to the provisions of entry 59 of List I with respect to opium.

20. Economic and social planning.

21. Commercial and industrial monopolies, combines and trusts.

22. Trade Unions; industrial and labour disputes.

23. Social security and social insurance; employment and unemployment.

24. Welfare of labour including conditions of work, provident funds, employers' liability, workmen's compensation, invalidity and old age pensions and maternity benefits.

25. Vocational and technical training of labour.

26. Legal, medical and other professions.

27. Relief and rehabilitation of persons displaced from their original place of residence by reason of the setting up of the Dominions of India and Pakistan.

28. Charities and charitable institutions, charitable and religious endowments and religious institutions.

29. Prevention of the extension from one State to another of infectious or contagious diseases or pests affecting men, animals or plants.

30. Vital statistics including registration of births and deaths.

31. Ports other than those declared by or under law made by Parliament or existing law to be major ports.

32. Shipping and navigation on inland waterways as regards

mechanically propelled vessels and the rule of the road on such waterways, and the carriage of passengers and goods on inland waterways subject to the provisions of List I with respect to national waterways.

[1]33. (Trade and commerce in, and the production, supply and distribution of,

(*a*) the products of any industry where the control of such industry by the Union is declared by Parliament by law to be expedient in the public interest, and imported goods of the same kind as such products;
(*b*) foodstuffs, including edible oilseeds and oils;
(*c*) cattle fodder, including oilcakes and other concentrates;
(*d*) raw cotton, whether ginned or unginned, and cotton seed; and
(*e*) raw jute.).

34. Price control.

35. Mechanically propelled vehicles including the principles on which taxes on such vehicles are to be levied.

36. Factories.

37. Boilers.

38. Electricity.

39. Newspapers, books and printing presses.

40. Archaeological sites and remains other than those [2](declared by or under law made by Parliament) to be of national importance.

41. Custody, management and disposal of property (including agricultural land) declared by law to be evacuee property.

[3]42. (Acquisition and requisitioning of property.)

43. Recovery in a State of claims in respect of taxes and other public demands, including arrears of land revenue and sums recoverable as such arrears, arising outside that State.

44. Stamp duties other than duties or fees collected by means of judicial stamps, but not including rates of stamp duty.

45. Inquiries and statistics for the purposes of any of the matters specified in List II or List III.

46. Jurisdiction and powers of all courts, except the Supreme Court, with respect to any of the matters in this List.

47. Fees in respect of any of the matters in this List, but not including fees taken in any court.

[1] Subs. by the Constitution (Third Amendment) Act, 1954.
[2] Subs. by the Constitution (S.A.) Act, 1956, s. 27, for 'declared by Parliament by Law'.
[3] Subs. by s. 26, ibid., for the O.E. 42.

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INDEX